
VA Handbook H26-94-1
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Veterans Benefits Administration
Washington, D.C.

# FOREWORD

a. This publication is a guide for program participants who hold and/or service VA-guaranteed home loans. It contains the servicing, claims, and conveyance policies and procedures applicable to VA loans, as well as a copy of the part of the Code of Federal Regulations dealing with VA loans.

b. The issuance of a VA guaranty on a loan is in part predicated upon the understanding that adequate loan servicing will be performed by the holder. This requirement is implied in the law and expressed in the regulations. Failure to comply with VA regulations regarding servicing, claims, and conveyance may result in a reduction of the amount of claim payable by VA. A pattern of failure may result in suspension from program participation.

c. Lending institutions and servicers are generally anxious to avoid a foreclosure and strive to maintain a low delinquency record. While many loan holders designate an agent to collect loan installments and/or perform other functions to protect the interests of the holder, it is the holder that remains responsible for compliance with the law and regulations governing VA-guaranteed loans.

d. The procedures and policies outlined in this handbook are intended to guide holders and servicers in servicing loans under the provisions of chapter 37, title 38, United States Code. Nothing contained in this handbook should be construed as modifying or otherwise altering any of the regulations affecting the Loan Guaranty Program in part 36 of title 38, Code of Federal Regulations or in title 38 of the United States Code. If there appears to be a discrepancy between the procedures and policies in this handbook and the related regulations or governing law, the latter will govern. Where possible, the number of the regulation related to VA policies and procedures is given in parenthesis.

## VA Regional Office Structure

a. The Veterans Benefits Administration operates a network of 58 decentralized field offices. Forty-six of these offices have Loan Guaranty operations. See appendix A for a list of VAROs (VA Regional Offices). Any correspondence regarding a specific loan, including the required notices of default and intention to foreclose, should be sent to the VARO with a Loan Guaranty operation that has jurisdiction over the county where the property securing the loan is located.

b. VA attempts to uniformly implement its major policies and procedures. However, regional offices are given some discretion in structuring their operations, which may result in variances on certain policies and procedures between regional offices. In addition, State laws regarding mortgages and foreclosures vary considerably. This also results in differences between VAROs, especially regarding the type of documents required and steps to be taken in foreclosure, in conveying title to acquired property to VA, and in pursuing alternatives to foreclosure. Each VARO issues Loan Guaranty Bulletins on the policies or procedures that may be different in their

jurisdiction. Holders should be on the mailing list of each VARO that has jurisdiction over an area where they hold loans. VA expects holders to be aware of the requirements of each local office .

## **Definitions** (38 CFR 36.4301)

a. An **automatic lender** is one that may process a loan or assumption without submitting the credit package to VA for review, pursuant to 38 U.S.C. 3702(d)

b. A **credit package** consists of any information, reports, or verifications used by a lender, holder, or authorized servicing agent to determine the creditworthiness of an applicant for a VA-guaranteed loan or the assumer of such a loan. This includes the prospective purchaser's application.

c. A **holder** is any institution that owns a loan guaranteed by VA. The holder is ultimately responsible for ensuring that all applicable VA policies, procedures, and regulations are followed. In this handbook, the word "holder" refers to both the actual loan holder and any designated servicing agent. When loans have been pooled through the GNMA (Government National Mortgage Association), whoever services the loan and has the right to file and receive payment of a claim under guaranty is considered the holder.

d. A **servicing agent** is an agent designated by the loan holder to collect installments on the loan and/or perform other functions to protect the interests of the holder. The servicing agent may perform any of the actions discussed in this handbook on behalf of the holder, including loan assumptions if the servicing agent is also an automatic lender.

e. A **default** is any failure of a borrower to comply with the terms of a loan agreement. If a payment due on the first of the month has not been received on the second, VA considers the loan to be in default on the second. If the payment has still not been received 30 days later, VA considers the loan to have been in default for 30 days.

f. The VA LIN (**VA Loan Identification Number**) is a 12 position unique identifier for each loan guaranteed by VA. The VA LIN consists of a two-position numeric code for the regional office which has jurisdiction over the loan (OJ), a two-position numeric code for the regional office which originated the loan (OO), a one-position code for the type of loan, and a seven position serial number or loan number. Appendix B, Circular 26-93-14, VA Loan Identification Numbers, provides a description of the VA LIN.

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# CHAPTER 1. CURRENT SERVICING

## 1.01 General

Holders are expected to service VA loans in conformity with procedures customarily used by prudent lenders in servicing portfolios of similar conventional loans. Loan holders' performance is also measured by their compliance with applicable Federal statutes, such as the RESPA (Real Estate Settlement Procedures Act), as amended, and laws and regulations governing the VA loan program.

## 1.02 Accounting Records (38 CFR 36.4330)

A record must be maintained of loan payments received and disbursements made and the dates of all transactions for each account. Since these records must accompany any claim filed under the guaranty, holders are encouraged to obtain and retain them for loans acquired through purchase or servicing transfers. If a claim is filed without complete accounting records, VA will assume that all payments were received and applied as scheduled during the period for which no records are provided.

## 1.03 Servicing Organization

a. **Servicing Operations** (38 CFR 36.4346(b))

(1) Loan holders are allowed wide latitude in organizing their servicing operations, but there are some VA requirements. All borrowers must be informed of the procedures and systems available for obtaining answers to inquiries. Holders will be reminded of these systems at least annually.

(2) Holders must either:

(a) Locate their servicing operations within a 200 mile radius of their loan accounts; or,

(b) Provide toll-free or collect calling services at an office capable of responding to requests for information.

b. **Quality Control Procedures.** (38 CFR 36.4346(l)) Loan holders must have internal controls which periodically assess the quality of servicing of VA loans and to assure that VA's servicing standards are met. An internal assessment of the holder's servicing activity must be conducted at least annually. The holder should:

(1) Collect and maintain appropriate data on delinquency and foreclosure rates to enable it to evaluate the effectiveness of its collection efforts;

(2) Determine how its VA delinquency and foreclosure rates compare with rates in reports published by the industry, investors and others; and,

(3) Analyze significant variances between its foreclosure and delinquency rates and those found in reports and publications and take appropriate corrective action.

This data and analysis must be provided to VA upon request. Requests may be made by VA's Central Office, lender/servicer monitoring units or VAROs.

c. **Duty to Respond to Written Borrower Inquiries.** RESPA, which was amended in 1990, requires the following strict deadlines for response to written borrower inquiries.

(1) **Twenty Business Days to Acknowledge** A qualified written request from a borrower, or agent of the borrower, relating to the servicing of his/her loan must be acknowledged in writing within 20 business days of receipt, unless the action requested is taken within 20 business days. A qualified written request must enable a servicer to identify the name and account of the borrower, and provide sufficient detail as to why the account is in error or other information requested by the borrower.

(2) **Sixty Business Days to Resolve** Within 60 business days of receipt of a qualified written request (as defined in subpar. (1) above) from a borrower or agent of the borrower about to the servicing of his/her loan, the servicer must complete an investigation and notify the homeowner of its results. The findings from this investigation should be used to determine which of the following three courses of action should be taken: correct the borrower's account and notify the borrower in writing of the correction; provide written explanation to the borrower if the account is correct; or, write the borrower with an explanation if the requested information is unavailable. The name and telephone number of the servicer to contact must be provided to the borrower in the notification.

(3) **Prohibition Against Reporting to Credit Agencies** During the 60 day investigation period (as defined in subpar. (2) above), information indicating a late mortgage payment on the account under investigation may not be reported to credit agencies.

## 1.04 Statement for Income Tax Purposes (38 CFR 36.4346(c))

VA requires that within 60 days after the end of each calendar year, the holder must furnish to the borrower a statement of the interest paid and the taxes disbursed from the escrow account during the preceding year. Since RESPA requires that this statement be furnished within 30 days after the end of the calendar year, holders must satisfy the RESPA requirement. At the borrower's request, the holder must furnish a statement of the escrow account that will enable the borrower to reconcile the account.

## 1.05 Advances (38 CFR 36.4313)

a. A holder may advance any amount reasonably necessary and proper for:

(1) Maintenance or repair of the security;

(2) Payment of accrued taxes, special assessments, ground or water rents;

(3) Premiums on fire, flood, or other casualty insurance against loss or damage to the property; and,

(4) If the commitment for the loan was made on or after March 1, 1988, one-half of one percent of the funding fee due on a transfer if it is not paid at the time of transfer.

b. The advance may be added to the guaranteed indebtedness. VA does not regulate the amount of advances that are allowable on a national basis, either as charges to the borrower or for purposes of claim computation, but VA regional offices set limits on amounts they consider reasonable. See paragraph 4.17, Acceptable Expenses, for more information.

c. Advances for payment of condominium or PUD homeowners association assessments may not be included in any accounting between a holder and VA without prior approval by VA.

## 1.06 Extensions and Reamortizations (38 CFR 36.4314)

a. **Conditions.** A loan may be extended or reamortized provided:

(1) The loan is in default or default is imminent; and,

(2) The borrower is a reasonable credit risk, based on a review by the holder of the borrower's creditworthiness, including a current credit report; and,

(3) At least 80 percent of the loan balance extended will amortize over the remaining term of the loan (or, for loans with a term of less than 30 years, the lesser of the economic life of the security or 30 years from the date of origination); and,

(4) No obligor is released from personal liability.

Otherwise, prior approval must be obtained from VA.

b**. Terms.** Any agreement to extend or reamortize the loan must be in writing and signed by the holder and the borrower. Accrued unpaid interest may be included in the loan indebtedness extended or reamortized. A deficit in the tax and insurance account may also be included in the indebtedness to bring the account up to the level it would have been had the borrower paid the required installments timely.

c. **Notification to VA.** Notify VA of the terms of the agreement (preferably a copy of the extension or reamortization agreement) after the agreement has been executed, along with a copy of the credit report.

## 1.07 Prepayments (38 CFR 36.4310)

a. **Requirements.** The borrower has the right to prepay at any time, without premium or fee, the entire indebtedness or any amount not less than the next monthly principal installment or $100, whichever is less. The holder retains the option to accept prepayment amounts which are smaller than the minimum required by regulation. Any prepayment less than payment in full which is made on a day other than an installment due date need not be credited until the following installment due date, or 30 days after the prepayment, whichever is earlier. Payment in full must be accepted and credited to the loan account when tendered, and no interest may be charged thereafter.

b. **Reapplication.** The holder and the borrower may agree at any time to re-apply prepayments to cure or prevent a default.

## 1.08 Servicing Fees

a. **Late Charges.** (38 CFR 36.4311(d)) A late charge may be collected on any installment received more than 15 days after its due date, provided the loan instruments contain a provision for a late charge.

(1) For example, a late charge may <u>not</u> be collected on an installment due on the first of the month if it is paid on or before the 16th of the month, but may be collected if the installment is paid on or after the 17th of the month.

(2) The late installment must be paid before the late charge is collected.

(3) The late charge may <u>not</u> be:

(a) More than 4 percent of any installment (principal, interest, and escrow for taxes and insurance);

(b) Based on an amount greater than the past due amount;

(c) Collected from the escrow account or from an escrow surplus without prior approval of the borrower;

(d) Deducted from regular payments; or,

(e) Included in a claim under the guaranty or in any accounting to VA.

(4) Late charges discourage late payments only if the borrower is able to pay on time but does not do so. If a borrower is cooperative but unable to pay, or if collection of late charges could prevent a borrower from reinstating a delinquent account, consideration should be given to waiving the late charge.

b**. Other Fees.** Fees for services outside the scope of the usual mortgage transaction depend on the terms of the loan agreement and should be determined by the parties involved. However, such charges must be reasonable, considering the work involved and the amount customarily charged in the locality. The charges listed below, while not approved by VA, are not considered improper when they are customary, agreed to by the parties, permissible under the loan agreement and are reasonable in amount:

(1) Loan assumption fees. (See pars. 1.13 and 1.14);

(2) Processing and reprocessing checks which are returned to the holder for insufficient funds;

(3) Substitution of hazard insurance policies during the life of a previously furnished policy, when substitution is made at the request of the mortgagor;

(4) Processing partial releases of the mortgaged property;

(5) Processing subordination agreements;

(6) Modification of the mortgage by a formal written extension or reamortization agreement; or,

(7) Marking the mortgage satisfied if authorized or not prohibited by local law.

## 1.09 Taxes and Insurance

a**. Payment of Taxes.** Security instruments uniformly require the obligor to pay taxes timely to prevent a lien with priority over the mortgage. Failure to pay taxes timely must be reported to VA if it continues for 180 days (38 CFR 36.4315(a)(2)). Most security instruments require maintenance of an escrow account by the holder to ensure payments are timely. Since VA requires the holder to maintain the priority status of the mortgage lien (38 CFR 36.4325(b)(1)), internal controls should be in place to confirm payment of taxes by the holder or the borrower.

b**. Maintenance of Hazard Insurance.** (38 CFR 36.4326) It is the holder's responsibility to assure that insurance policies are maintained in an amount sufficient to protect the security against risks or hazards and to the extent customary in the locality. Questions about the insurance coverage should be referred to the VA regional office of jurisdiction. Subject to reasonable requirements of mortgagees, borrowers may choose their insurance carrier.

c. **Prohibitively High Premiums**

(1) Holders should not pay prohibitively high insurance premiums for force-placed coverage without prior approval of VA. If the hazard insurance is canceled (other than for nonpayment of premium) or renewal is refused, holders should attempt to obtain coverage through a State pool or otherwise. If coverage cannot be obtained except at prohibitive cost, the holder should promptly send VA the following information:

(a) The reason for cancellation or for the refusal to renew the coverage;

(b) The evidence of efforts made to obtain coverage and if obtainable, the lowest cost for such coverage;

(c) The amount and type of coverage of the policy being canceled or not renewed;

(d) The condition and current estimated value of the property improvements and the cost of any repairs required to obtain coverage;

(e) The current estimated value of the land; and,

(f) The current unpaid principal balance of the loan.

(2) Upon receipt of notification, VA will determine whether or not it is in VA's interest to give the holder assurance that a future claim under guaranty will not be adjusted for failure to maintain hazard insurance and advise the holder of the determination.

d. **Insurance During Loan Termination.** When a loan is being terminated and existing coverage has been canceled or renewal refused and the holder is unable to obtain hazard insurance except at high cost, the holder should advise VA. At the same time, the holder may request that VA not make a claim adjustment for failure to maintain hazard insurance in the event of an uninsured loss. Alternatively, the holder may choose to obtain high risk insurance rather than rely on receiving VA's assurance that a future claim would not be adjusted for failure to obtain hazard insurance. In such cases VA will partially reimburse the cost of high risk insurance in the claim. Reimbursement is based upon the portion of the premium attributable to coverage to the date of loan termination or to the date termination should have occurred (i.e., the cut-off date), whichever is earlier. The percentage of guaranty is then applied to this portion of the premium. The resulting amount is payable in the claim.

e. **Amount Required.** The amount of hazard insurance required is limited to the insurable value of the property or the current loan balance, whichever is less. The borrower may take out a larger policy if desired.

f. **Flood Insurance.** (38 CFR 36.4326) Flood insurance is required on loans closed on and after March 2, 1974, located in a special flood hazard area designated by HUD (Department of Housing and Urban Development) where flood insurance is available under the National Flood

Insurance Program. The amount of insurance should be the outstanding balance of the loan or the maximum limit of coverage available, whichever is less.

g. **Application of Loss Payments** (38 CFR 36.4326)

(1) All payments for insured losses must be applied to the restoration of the security or to the loan balance. (See par. 6.06d(2).) Any other disposition must be approved in advance by VA, unless there is a balance remaining after the security has been fully restored.

(2) Settlement of a total or near total loss case should be sufficient to restore the security. When it appears that settlement proceeds will not be sufficient to pay off the loan balance or to restore the security, holders should consult VA before consenting to an insurance settlement. The holder should send VA a copy of the claim adjuster's report giving a detailed breakdown of the damage sustained. VA will also inspect the property before any loss settlement and estimate the cost of repairs.

(3) If the settlement proceeds are not to be applied to the loan balance, VA can assist holders in obtaining the services of compliance inspectors, at the holder's or borrower's expense, to assure satisfactory restoration of the security.

(4) To minimize the possibility that a claim may be adjusted for failure to obtain an adequate loss settlement, holders are encouraged to advise VA as soon as a major loss has occurred and obtain VA's estimate of the cost of restoration before accepting a loss settlement. Holders should also be cautious about completing foreclosure while a loss is pending settlement because sale proceeds may affect settlement. In some jurisdictions, it may be possible to have a disputed settlement adjudicated as part of the foreclosure proceedings, but holders should keep VA advised of their efforts to settle a disputed loss claim.

## 1.10 Escrow/Impound Account Maintenance (38 CFR 36.4346(e))

a. **Escrow/Impound Accounts.** Holders are not required to collect periodic deposits for tax and insurance or maintain a tax and insurance account but may do so if authorized under the terms of the security instruments. Holders must comply with the provisions of RESPA as administered by HUD.

b. **Disposition of Excess Balances.** An excess balance in the tax and insurance account should be disposed of as provided in the loan agreement and required by RESPA. With the consent of the borrower, VA will not object to applying the excess balance to delinquent installments. Similarly, and with the consent of the borrower, application of the excess to the principal balance or refunding it to the borrower would be acceptable provided that no obligor is released from liability on the loan. On current accounts, if the borrower does not provide specific instructions for disposition of a surplus, it may be remitted directly to the borrower.

## 1.11 Servicing Transfers (38 CFR 36.4346(d))

Lenders or holders are not required to notify VA of, or obtain VA approval for, servicing transfers or sub-servicing transfers. It is recommended, however, that VA be given notice on active delinquencies (cases on which a notice of default has been filed) so that follow-up on these cases is maintained. In servicing transfer cases, the transferee will be held responsible for any failure of the transferor to comply with VA requirements (other than those discussed in par. 6.06 which are not applicable to a holder in due course) which would subject the claim to adjustment. Both the releasing and acquiring holder/servicer must comply with the disclosure and notification requirements of RESPA as administered by HUD.

## 1.12 Release of Security (38 CFR 36.4324)

a. **General.** VA will be released from all liability as guarantor if (1) a holder releases a portion of the security from the lien without VA's prior approval, and (2) the obligor is released from personal liability on the entire indebtedness. Even if an obligor is not released from liability, a claim may be reduced if a portion of the security was released without following the guidelines below.

b. **Prior VA Approval Not Required.** Holders may approve partial releases of security without VA's prior approval if all of the following conditions are met:

(1) The release did not involve a decrease in value of the security in excess of $2,500;

(2) The consideration received for the release is commensurate with the fair market value of the property released;

(3) The entire consideration is applied to the indebtedness;

(4) The aggregate amount of the release does not exceed $2,500; and,

(5) Any release or substitution of security is reported to the appropriate VA regional office within 30 days after completion of the transaction.

c. **Other Releases**

(1) All other releases must have the prior approval of VA. The request for approval should be submitted to the appropriate VA regional office and should contain:

(a) A letter of request from the current owner signed by all interested or obligated parties to the loan, such as the original veteran and secondary lienholders. An explanation must be provided if any person liable on the loan does not sign the request.

(b) A survey or sketch of the entire parcel showing clearly the portion to be released, the dimensions of the parcels, and the locations of all improvements.

(c) The status of loan, including the current unpaid principal balance and whether the loan payments are current.

(d) The consideration, if any, to be received for the property.

(e) The details of the intended disposition of funds, if consideration is not going to be applied to the indebtedness.

(f) Any available indication of the value of the property being released.

(g) A statement from the borrower agreeing to pay for the cost of an appraisal or survey if VA determines one is necessary.

(2) In general, the consideration received for the release must be at least equal to the reasonable value of the security released. If the entire consideration is not used to reduce the indebtedness, the ratio of loan balance to the remaining security must be adequate to protect VA against possible future loss in case of liquidation of the remaining security. VA will generally consider a loan-to-value ratio of 75 percent or lower to be adequate.

(3) Depending on the factual situation, VA may order a land survey of the property and/or an appraisal showing the reasonable value before and after the partial release to be made. The persons requesting the release will be required to pay the expense of the appraisal and/or land survey whether or not VA approves the request.

(4) VA will advise the holder by letter of the decision and give notice of any conditions required for approval of the request for release.

## 1.13 Loan Assumptions and Release of Liability--Loans Made Prior to March 1, 1988

### a. Right to Sell

(1) The owner of property that is security for a VA loan for which a commitment was made prior to March 1, 1988, has the right to sell the property on any terms. No restriction, charge or fee may be imposed by a holder or its servicing agent that would limit or nullify this right.

(2) An exception applies when the loan was made by a State, territorial, or local governmental agency and the law requires acceleration of maturity of the loan upon sale or conveyance of the security property to a person ineligible for assistance. VA has approved due-on-sale clauses to allow veterans to participate in certain programs that require them to allow veterans to take advantage of below-market interest rates or other benefits.

b**. Fees.** VA does not approve fee charges for recording change of ownership of the mortgaged property. However, holders may charge up to $50 for amending their records to reflect a change in ownership, if the parties involved agree and it is permissible under the loan agreement.

c**. Liability of the Veteran.** The original mortgagor remains liable on the mortgage indebtedness unless he or she is released from personal liability. Under Federal law and VA regulations, the original veteran-borrower is obligated to indemnify the Government for any amount VA is required to pay the holder under the contract of guaranty. (For loans closed after December 31, 1989, however, veterans will not be required to reimburse the Government for claim payments except when evidence of fraud, misrepresentation or bad faith in connection with the loan origination or default is found.) This indemnity obligation is in addition to any rights VA may acquire by subrogation from the holder. VA encourages holders to include language on pay-off statements which reminds veterans of their liability and recommends that they obtain a release of liability from VA before permitting a loan assumption.

d**. Requirements for Release of Liability**

(1) Upon application made by a veteran and the transferee, VA will release the veteran from liability to the Government on the loan if the following three conditions are met:

(a) The loan is current;

(b) The purchaser qualifies as an acceptable credit risk; and,

(c) The purchaser assumes the veteran's loan obligations and liability (including the veteran's indemnity obligation), as evidenced by a written agreement in the form required by the VA office of jurisdiction or one that is found to have the same legal effect.

(2) The party assuming the loan need not be a veteran. A veteran may take advantage of this procedure regardless of whether the house was sold at a profit. The veteran's release also applies to the spouse.

e**. Effects on Holder.** A holder is not required to release the veteran from liability to it. The veteran's release from liability to VA will not affect the holder's rights to proceed against the veteran or affect the holder's contract of guaranty.

f**. Processing of Applications.** A release of liability must be processed by the VA office having jurisdiction over the loan. Holders will be requested to supply certain information, such as the current status of the loan, during the processing.

g**. Notice to Holders.** Generally, the loan holder will not be notified that a release had been granted unless notice was specifically requested. VA began to provide holders with copies of the obligor's release notification letter in mid-1993.

## 1.14 Loan Assumptions and Release of Liability--Loans Committed On or After March 1, 1988

a. **Limited Assumability.** Assumptions of loans for which loan commitments were made on or after March 1, 1988, must have the prior approval of VA or a VA automatic lender. With the exception of assumptions processed under the "special approval by VA" procedure described in subparagraph f below, approval of an assumption of a loan releases the veteran from liability to VA. The security instruments are required to carry a statement, in large type, that the loan may not be assumed without VA's prior approval. Failure to secure approval could lead to the acceleration of the loan after the transfer. Assumptions and releases of liability are generally processed by holders and include a funding fee and processing charge.

b. **Funding Fee** (38 CFR 36.4312(e))

(1) Funding fee equal to one-half of 1 percent of the loan balance as of the date of transfer must be paid by the transferee to the loan holder or its agent, at the time of transfer. The following are exempt from paying the funding fee as an assumer:

(a) A veteran receiving VA compensation for a service-connected disability;

(b) A veteran who, but for receipt of military retirement pay, would be entitled to receive compensation; and,

(c) A surviving spouse of a veteran who died in service or from a service-connected disability.

(2) See VA Pamphlet 26-7, Lender's Handbook, chapter 6, section II, for more information on exemptions from the funding fee and acceptable documentation.

(3) The holder should list the funding fee amount in every assumption statement provided and include a notice that the fee must be paid to the holder immediately following loan settlement.

(4) The holder must send the fee to the Secretary of Veterans Affairs within 15 days of the receipt by the holder of the notice of transfer. Transmittal of the funding fee to VA must be completed in accordance with VA Pamphlet 26-7, Lender's Handbook, chapter 6, section II. The loan amount (item 10) on the transmittal form (VA Form 26-8986, Loan Guaranty Funding Fee Transmittal, see fig. 1-1) will be the balance of the loan assumed by the new owner rather than the original loan balance. However, the date of loan closing (item 9) will be the date the loan originally closed, not the transfer date.

c. **Processing Charge.** (38 CFR 36.4312(d)(8)) The maximum charge for processing an assumption application and changing the loan records is the lesser of:

(1) $300 plus the actual cost of any credit report required; or,

(2) Any maximum prescribed by applicable State law.

A holder may collect this charge in advance, including a reasonable estimate for the cost of the credit report, and then refund the portion allocable to a records change ($50) if the transfer is not completed. A charge of $50 is for underwriting the assumption. If VA is underwriting, the $50 charge cannot be assessed or must be refunded. VA does not specifically regulate when the $300 charge may be assessed; however, since borrowers or brokers may request an assumption package before a sales contract has been signed, it is recommended that holders require that the fee accompany the completed package rather than requiring it as a condition for mailing the forms to a requester.

d**. Processing of Assumptions - Automatic Lenders** (38 CFR 36.4303(k)(1))

(1) **Responsibility.** If both the holder and its servicing agent are automatic VA lenders, they must decide which one will make the determinations described below. If the actual loan holder does not have automatic authority and its servicing agent is an automatic lender, the servicing agent must make the determinations for the holder. The holder will remain responsible for any failure of its servicing agent to comply with the applicable law and VA regulations.

(2) **Processing and Underwriting.** If the seller applies for approval of the assumption prior to completing the sale, a holder or its authorized servicing agent who is an automatic lender must examine the application to determine compliance with the following provisions of 38 U.S.C. 3714:

(a) The loan is current (or will be brought current at the closing of the sales transaction).

(b) The prospective purchaser of the property is creditworthy. The creditworthiness review must be performed by the party that has automatic authority and must be conducted in accordance with 38 CFR 36.4337 and VA Pamphlet 26-7, Lender's Handbook, Chapter 5, Section II.

(c) The prospective purchaser has agreed to assume all of the loan obligations, including the obligation to indemnify VA if a claim is paid.

(3) **Timeliness Requirements.** The holder must complete its examination and advise the seller of its decision no later than 45 days after the holder receives a complete application package for approval of an assumption. The 45-day period may be extended by the amount of time lost to delays documented as beyond the control of the holder, such as employers or depositories not responding to requests for verifications or follow-ups on requests.

(4) **Approval Notices.** When advising the seller that the assumption has been approved, the holder should include instructions for the assumption of liability (see subpar. b below) and the amount of funding fee which will be payable. After the transfer is completed, the holder must send VA:

(a) The credit package containing an application, loan analysis, credit report, verifications of income and deposits, and other pertinent information used to support the income and credit

determination. If this information was previously submitted in connection with an appeal, it will not be necessary to send duplicate copies.

(b) A copy of the executed deed and/or assumption agreement as required by the VA office of jurisdiction. Requirements for assumption of liability to a loan holder and to VA will vary according to local law. Each VA regional office has prepared for each State under its jurisdiction an information package describing the usual requirements for assumption of liability, as well as procedures to follow for unusual cases. Holders should obtain a package for each State in which they do business.

(c) A certification by the holder's or servicer's VA-approved underwriter that the assumption complies with the applicable law and regulations.

(d) A copy of the VA receipt for the assumption funding fee.

(5) **Disapproval Notices.** If the application for assumption is disapproved, the holder must notify the seller and the purchaser that the decision may be appealed to VA within 30 days. When a case is appealed to VA, the holder must provide VA all items it used in making its decision. If the application remains disapproved after 60 days (to allow time for appeal and review by VA) the holder must refund $50 if it previously collected any processing charge, because there will be no need for a records change.

(6) **Appeal to VA.** If the assumption is approved on appeal, VA will notify the seller and loan holder. If it is not approved, VA will notify the seller and holder and advise the seller of the right to request "special approval" within 15 days of receipt of the disapproval notice.

e. **Processing of Assumptions - Holders and Servicers Without Automatic Authority** (38 CFR 36.4303(k)(1)(ii))

(1) **Usual Processing.** If neither the holder nor its authorized servicing agent is an automatic lender, and the seller applies for approval of the assumption prior to completing the sale, the holder or its agent must develop a complete credit package for VA to determine the creditworthiness of the purchaser. This package must be sent to VA along with a copy of the purchase contract and information as to whether the loan account is current or in default.

(2) **Timeliness Requirements.** Documents must be submitted to the VA regional office of jurisdiction no later than 35 days after the date the holder receives a complete application package, subject to the same extensions for documented delays previously described for automatic lenders in subparagraph d(3) above. If VA advises that a proposed assumer is creditworthy and the transfer is completed, the holder will be required to timely submit the appropriate documentation to VA (see subpar. d(4) above), although the certification will not require the signature of an underwriter, and will state only that the application for assumption approval was processed in accordance with the applicable law and regulations.

(3) **Processing Charge and Refunds.** If the maximum processing charge of $300 was collected with an application for assumption approval (based on the possibility that a firm may be servicing loans for holders with and without automatic authority) and the credit package must be referred to VA for the underwriting decision, then $50 of the maximum charge must be refunded. If VA does not approve the application or if the appeal is denied, the holder will be notified and an additional $50 of the processing charge must be refunded following the expiration of the 30-day appeal period because this amount will not be needed to complete a records change.

f**. Special Approval by VA.** Within 15 days of receipt of the disapproval notice, the seller may request "special approval" from VA. VA may determine "special approval" is in the best interest of the Government if:

(1) The transferor agrees to remain secondarily liable on the loan following assumption,

(2) The transferor is unable to otherwise continue payments on the loan, and

(3) Reasonable efforts have been made to find a creditworthy buyer for the property.

If approved, VA will provide notice to the transferor and the loan holder that the assumption has been approved and that he or she will not be released from liability to VA. The "special approval" by VA does not include approval for the loan holder to release any obligor from liability. If an obligor is released by the loan holder without VA's prior approval, VA may be released from further liability on the guaranty.

g. **Transfer Without Prior Approval.** (38 CFR 36.4303(k)(2)) The holder must notify VA within 60 days after learning of a transfer that did not receive prior approval of VA or an automatic lender. The notice must advise VA whether the holder intends to exercise its option to immediately accelerate the loan or whether the transferor and transferee will be given the opportunity to apply for "retroactive approval" of the assumption. In this context, the phrase "acceleration of the loan" means referral to an attorney to initiate foreclosure.

(1) **Review of Purchaser's Liability.** Upon learning of an unapproved transfer, a holder may decide to demand immediate payment of the one-half of one percent VA funding fee and request a copy of the instrument of transfer to determine the liability of the purchaser.

(a) **Liability Assumed.** If the purchaser pays the funding fee and has assumed all of the seller's obligations in the transfer deed (and if the assumption language is legally binding), then it would appear that the purchaser intends to satisfy those obligations and an opportunity for retroactive approval of the transfer probably should be afforded.

(b) **Liability Not Assumed**. If prior approval of a transfer was not obtained and the title transferred "subject to" the mortgage or deed of trust, then the purchaser usually has no liability on the loan. Such a purchaser may have no incentive and little intention of maintaining the payments. It may still be advisable to extend the opportunity to apply for retroactive approval of the transfer, with the expectation that the purchaser will assume liability for repayment of the loan.

(2) **Retroactive Approval Processing.** If an opportunity to apply for retroactive approval is granted, processing will be completed in the same manner as if the application had been received prior to the transfer, including the right of appeal to VA.

(3) **Consideration of Loan Acceleration.** Should a purchaser fail to cooperate in the retroactive approval process, then acceleration of the loan may or may not be advisable, depending upon the implications under State law of delaying acceleration, as compared to the prospect of accelerating a current loan which has the potential for future timely payments.

h. **Release of Liability.** (38 CFR 36.4323(h)) When an application for assumption is approved (either by VA or the loan holder or servicer) and the transfer is completed with the purchaser assuming all of the seller's liability on the loan and to VA, the holder must release the seller of further liability to VA. This may be done in letter form if not a part of an assumption agreement, or if an agreement is not required. If it desires to do so, the holder is also authorized to release the seller from liability to the holder on the loan without separate approval from VA. This does not apply if the seller has agreed to remain liable and has obtained "special approval" for the assumption from VA.

i**. Unrestricted Transfers.** (38 CFR 36.4308(c)(1)) Certain transfers of ownership otherwise subject to 38 U.S.C. 3714 do not require prior approval of the holder, as described below. A loan may not be accelerated due to these types of transfers, and a release of liability will not be processed by the holder. Application for release of liability on unrestricted transfer cases must be processed by VA. The processing charge and funding fee may not be collected. However, a reasonable fee up to $75 may be charged for changing the holder's account records, provided it is agreed to by the parties or is permissible under the loan agreement.

(1) The creation of a lien or other encumbrance subordinate to the lender's security instrument which does not relate to a transfer of rights of occupancy in the property;

(2) The creation of a purchase money security interest for household appliances;

(3) A transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;

(4) The granting of a leasehold interest of 3 years or less not containing an option to purchase;

(5) A transfer to a relative resulting from the death of a borrower;

(6) A transfer when the spouse or child of the borrower becomes a joint owner of the property with the borrower;

(7) A transfer resulting from a decree of a dissolution of marriage, legal separation agreement, or from an incidental property settlement agreement by which the spouse of the borrower becomes

the sole owner of the property. In such a case, the borrower has the option of applying directly to the VA regional office of jurisdiction for a release of liability under 38 U.S.C. 3713(a); or

(8) A transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property.

j. **Sale Agreements Not Subject to 38 U.S.C. 3714.** A sale on an installment contract, contract for deed, or similar arrangement in which title is not transferred from the seller to the buyer is not considered a "disposition" of property and therefore does not require prior approval by VA or the loan holder. However, the holder should caution any borrower considering a sale in this manner that he or she remains liable for repayment of the loan under such an arrangement.

(1) **Loan Records**. Even if the agreement calls for the contract purchaser to make payments directly to the loan holder, the holder is not required by VA to change its records, and the contract seller is responsible for forwarding payment coupons and other information to the contract purchaser. Depending on the circumstances of a case, a holder may agree to change the account address to read in care of the contract purchaser, although the contract seller must promptly advise the holder of any change in his or her address.

(2) **Eventual Title Transfer on Contract Sales** Sales by installment contracts typically call for transfer of title after a certain period of time. If the contract calls for title to transfer prior to payment in full of the VA loan, assumption approval will be required, and processing charges and VA funding fees will be applicable upon transfer. The borrower should be advised to include as one of the conditions of the contract that application for assumption approval be made, and approval secured, prior to the completion of title transfer. The contract should then address the options of both parties if the request for assumption approval is disapproved. Among the options could be voiding the contract with forfeiture of all payments previously made, or an extension of the contract period to allow the purchaser to correct any credit deficiencies and apply for approval at a later date.

k. **Substitution of Entitlement.** VA will continue to process the substitution of entitlement on assumption cases, although this will usually be done only after a holder has provided notice of an approved transfer. If a review of the sales contract indicates it is contingent upon restoration of VA benefits, or if a question about the possibility of substitution of entitlement arises, the seller should be referred to the VA office of jurisdiction. To complete a substitution, the buyer must have sufficient entitlement to substitute for that of the seller, and this information can usually be obtained only from VA. In addition, the veteran-buyer must certify that the property securing the loan will be occupied as his or her home using VA Form 26-8106, Statement of Veteran Assuming GI Loan (Substitution of Entitlement). In some cases, VA Form 26-8320, Certificate of Eligibility for Loan Guaranty Benefits, may be valid only if the veteran provides a certification that he or she has not been released from active duty at the time a loan is obtained or assumed.

l. **Transmittals to VA.** Appendix C provides detailed instructions on origination loan file setup for prior-approval applications and closings, and for automatic loans. The same order is appropriate in providing items required by the various types of notices which will be submitted on

assumption approvals and releases of liability. Processing at VA will be expedited if holders include a cover letter identifying it as a completed transfer, a request for approval by VA, or information on an appealed case. The cover letter should also identify the VA loan number, original veteran, and the name and telephone number of a contact person at the holder/servicer. Any indication of a request for substitution of entitlement should also be noted.

## 1.15 Soldiers and Sailors Civil Relief Act

a. The Soldiers and Sailors Civil Relief Act of 1940, as amended (50 USC App. sections 501-590) provides for a loan interest rate cap of 6 percent and other relief for veteran-borrowers called to active military service on loan obligations incurred prior to their current period of service. Foreclosures must be approved by the court. If a claim is filed, VA will not include interest on the obligation in excess of 6 percent for the period of time the veteran was eligible for the rate reduction provisions of the Act.

b. Appendix D, Circular 26-90-32, provides more information about the Act. Holders are advised to consult counsel to ensure compliance with all provisions of the Act as well as any local statutes that may require the extension of forbearance. VA does not administer the Act.

## 1.16 Loans Paid in Full (38 CFR 36.4333)

Upon full satisfaction of a guaranteed loan by payment or otherwise, the holder must return the certificate of guaranty to VA marked canceled. If the certificate is not available, the holder must still inform VA in writing that the loan has been paid in full.

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## CHAPTER 2. DELINQUENT SERVICING

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# CHAPTER 2. DELINQUENT SERVICING

## 2.01 System for Servicing Delinquent Loans (38 CFR 36.4346(f))

VA has a keen interest in delinquent loan servicing both because of the Government's financial obligation as guarantor and because of the responsibility to provide assistance to veterans. Holders must have a system for servicing delinquent loans which ensures that prompt action is taken to collect amounts due from borrowers and minimizes the number of loans in default. The holder's servicing system must include the following:

a. An accounting system that promptly alerts servicing personnel when a loan becomes delinquent.

b. A collection staff trained in the techniques of loan servicing and counseling delinquent borrowers about:

(1) How to cure delinquencies;
(2) Protecting their equity and credit rating; and,
(3) Alternatives to foreclosure.

c. Procedural guidelines for the individual analysis of each delinquency.

d. Instructions and controls for:

(1) Sending delinquent notices;
(2) Assessing late charges;
(3) Handling partial payments;
(4) Maintaining servicing histories; and,
(5) Evaluating repayment proposals.

e. Management review of collection efforts and borrower response prior to a decision to start liquidation.

f. Procedures for reporting delinquencies of 90 days or more and loan terminations to major credit bureaus and for informing borrowers that such action will be taken. (VA does not object to reporting delinquencies earlier or to full file reporting.)

g. Controls to ensure that required notices are sent to VA on time and in the proper form.

## 2.02 Collection Actions (38 CFR 36.4346(g))

Holders should employ collection techniques which are flexible enough to adapt to the individual needs and circumstances of each borrower. A variety of collection techniques may be used, although the holder's collection procedures must at least include the following:

a. **Delinquent 17 Days.** If a loan installment has not been received within 17 days after it is due, the borrower must be sent a written delinquency notice requesting immediate payment. The notice must be mailed no later than the 20th day of the delinquency and must state the amount of the payment and of any late charges that are due.

b. **Telephone Contact.** Concurrent with the delinquency notice (in any event, no later than the 30th day of the delinquency), an attempt should be made to contact the borrower by telephone to determine why payment was not made and to emphasize the importance of remitting loan installments as they come due.

c. **Delinquent 30 Days.** If telephone contact has not been made, a second letter, preferably personally worded, must be sent to the borrower. The letter should:

(1) State that the loan is in default.

(2) Emphasize the seriousness of the delinquency and the importance of taking prompt action to resolve the default.

(3) Report the total amount due.

(4) Advise the borrower how to contact the holder to make arrangements for curing the default.

d. **Face-to-Face Interview.** A reasonable effort to arrange a face-to-face meeting must be made if the holder has not established contact with the borrower and has not determined the borrower's financial circumstances or established a reason for the default or obtained the borrower's agreement to a repayment plan before the default is reportable to VA. Services of a third party, such as a property inspection contractor, may be obtained for this purpose. Holders have the option of authorizing a third party contractor to perform all, or some, of the servicing actions outlined in paragraph 2.03 or restricting them to referring the borrower to the holder's office for completion of a servicing interview.

**e. Failure to Perform.** The holder must explain any failure to perform these collection actions when reporting loan defaults to VA.

## 2.03 Conducting Interviews with Delinquent Borrowers (38 CFR 36.4346(h))

When personal contact with the borrower is established, the holder should solicit enough information to evaluate the prospects for curing the default and to decide whether forbearance or other relief assistance would be appropriate. At a minimum, the holder must make a reasonable effort to establish the following:

a. The reason for the default and whether the reason constitutes a temporary or permanent condition;

b. The borrower's present income and employment;

c. The current monthly expenses of the borrower, including all household and debt obligations;

d. The borrower's current mailing address and telephone number; and,

e. A realistic and mutually satisfactory arrangement for curing the default.

## 2.04 Property Inspections (38 CFR 36.4346(i))

a**. When to Inspect.** The holder should make an inspection of the mortgaged property whenever it becomes aware that its physical condition may be in jeopardy. Unless a repayment agreement is in effect, a property inspection must also be made at the following times:

(1) Before the 60th day of delinquency or before initiating action to liquidate a loan (i.e., referring the case to an attorney to begin foreclosure), whichever is earlier;

(2) At least once each month after liquidation proceedings have been started, unless servicing information shows the property remains owner-occupied.

A reasonable fee for property inspections required by VA may be charged to the borrower if permitted by the loan instruments and included in a claim filed with VA if the account is not reinstated. VA should be notified in writing if any damage to the property is found (the notice of default may be used for this purpose if one has not yet been filed when the damage is found; otherwise, a letter or memorandum should be sent).

b**. Abandonment.** When a holder obtains information that a mortgaged property is abandoned, it should make appropriate arrangements to protect the property from vandalism and the elements. Thereafter, inspections should be scheduled at least monthly to prevent unnecessary deterioration due to vandalism or neglect. For any loan more than 30 days delinquent, a property abandonment must be reported to VA and appropriate action (i.e., referral to counsel to initiate foreclosure) initiated within 15 days after the holder confirms the property is vacant. See paragraph 4.06 for instructions on filing VA Form 26-6850a, Notice of Default and Intention to Foreclose. VA can waive this requirement if there is reason to believe the account will be reinstated. Reasonable judgment should be exercised in considering all circumstances--property condition, for sale signs, date of last payment received, presence of personal property or vehicles,

yard condition, owner's mailing address, etc.--and arriving at a conclusion as to whether a property is abandoned or temporarily vacant.

## 2.05 Collection Records (38 CFR 36.4346(j))

Individual file records of collection action on delinquent loans must be maintained and made available to VA for inspection on request. Paper files, database records, or any combination are acceptable, as are designations used to identify standardized form letters and notices. The collection records must contain:

a. The dates and content of letters and notices which were mailed to the borrower(s);
b. Dated summaries of each personal servicing contact and the results;
c. The indicated reason for default; and,
d. The date and result of each property inspection.

This information must be reported on the notice of default and the notice of intention to foreclose forms.

## 2.06 When and How to Report the Default (38 CFR 36.4315(a))

a**. General**. The holder must notify the VA office of jurisdiction within 45 days after a borrower is in default:

(1) By reason of nonpayment of any installment for 60 days from the date of first uncured default; or,

(2) By failing to comply with any other covenant or obligation of the loan for a continuing period of 90 days after demand for compliance has been made. Nonpayment of real estate taxes do not need to be reported until the failure to pay when due has persisted for 180 days.

The NOD (VA Form 26-6850, Notice of Default), should be used to report the default.
For nonpayment default, VA must be in receipt of the NOD within 105 days of the date of the first uncured default. Failure to report timely could lead to an adjustment of any claim under guaranty. (38 CFR 36.4325(b))

**b. Assumptions**

(1) For loans closed based on commitments issued after March 1,1988 (which cannot be assumed without prior approval), VA must be notified on VA Form 26-6850 within 60 days after the holder learns of an unapproved change of ownership.

(2) For older loans which can be assumed without prior approval, an NOD should be filed within 15 days after two installments are due and unpaid, if an assumption took place less than 12 months before the date of first uncured default. (Early reporting in these cases is not mandatory,

but is strongly recommended because it can reduce losses caused by transfer of property to equity skimmers or unqualified buyers.)

c. **Abandonments.** VA Form 26-6850a should be used if the property is abandoned or if it is determined that the default is insoluble before the NOD has been filed. Abandonments, as well as cases when the default is determined to be insoluble before 60 days have elapsed from the date of first uncured default, should be reported promptly. NOTE: 38 CFR 36.4346(i) requires holders to begin action under 38 CFR 36.4317(a) within 15 days after confirming a property is abandoned. If the loan is in default, VA will construe "appropriate action" under the regulation as referral of the case to counsel for initiation of foreclosure. While the regulations do not specifically require that a notice of default be filed under these circumstances, VA asks holders to do so, using VA Form 26-6850a.

d. **Cures.** If the loan was previously in default but has been reported cured, a new NOD must be filed. If there is any question as to whether a cure was reported, a new NOD should be filed to avoid the risk that a subsequent claim will be adjusted for failure to report the default timely. VA will treat the NOD as a status update if no cure has been processed.

## 2.07 VA Form 26-6850, Notice of Default

An example of a properly completed NOD appears in figure 2-1. In filling out the NOD, holders should pay special attention to the following:

a. **VA LIN (VA Loan Identification Number)** The VA LIN must be numeric and 12 digits in length. Many VA loan numbers in holders' records have less than twelve digits because of the way they were assigned by the VA regional office of jurisdiction. They should be converted to the correct VA LIN in accordance with the instructions in appendix B.

b. **Holder's and Servicing Agent's Phone Number** A specific, direct line, telephone number enables VA loan service representatives to contact the proper specialist in the holder's servicing department when discussion of a case is necessary.

c. **Date of First Uncured Default (Item 2)** This is the due date of the first or earliest partially or fully unpaid installment.

d. **Present Owner's Social Security Number (Item 3A)**

e. **Present Owner's Telephone Number (Items 17E and 17F)** A diligent effort should be made to obtain the telephone numbers for both the property owner's place of employment and home. If numbers are not available, note in the servicing summary what efforts have been made to obtain them. This will prevent duplication of effort when VA begins supplemental servicing.

f. **Original Veteran's Name and Present Address (Item 8)** If someone other than the original veteran is the present owner, the name and current address of the original veteran should be provided. For purposes of the NOD, the original veteran's name is required by 38 CFR

36.4332; his or her current address should be the most recent available in the holder's system of records (after a notice of intention to foreclose is filed, holders must make an effort to determine the original veteran's current address--see par. 4.07). Because veterans may be held liable to reimburse the Government for claims paid due to transferee defaults, VA requires this information to try to provide veterans with notice of transferee defaults. In some areas, generally those in which foreclosure cannot be completed quickly, it is not essential that VA have this information at the time the NOD is filed. Since many holders do not retain data on prior obligors in their automated servicing records, each VA office of jurisdiction has issued a release informing holders whether or not they must strictly adhere to this regulatory requirement.

g. **Reason for Default (Item 19).** Usually there are reasons other than for default besides "improper regard." Check for curtailment of income, marital difficulties, illness or injury, extensive obligations, etc. Use item 19 if no contact has been made with the borrower and the reason for default is unknown.

h. **Summary of Loan Servicing (Item 20).** It is very important that VA have complete information about the default and the prospects for resolution. Use the back of the NOD or separate sheet of paper if more space is needed. A narrative summary of any contacts made with the borrowers is helpful in evaluating the prospects of a loan reinstatement and for VA supplemental servicing. A copy of the in-house servicing record is acceptable as long as the VARO has been provided with instructions on how to read it and explanations of any abbreviations it contains.

i. **Signature (Item 22).** The form must be signed by a corporate officer or other authorized full-time employee of the holder or its servicing agent. If the proper signature is omitted, the form will be returned for signature. The individual signing the notice should review the form to see that the information provided is accurate.

j. The NOD must include certification that the default has been reported to the credit bureaus.

## 2.08 Interim Loan Status Reports to VA

a. On loans reported in default, VA regularly produces a computer-generated VA Form 26-8778, Request to Lender for Status of Loan Account-LCS. This form should be completed and returned without delay. The information provided updates VA's records and assists in determining the viability of the loan. Failure to provide updates timely may result in the establishment of premature cut-off dates under 38 CFR 36.4319(f) and unnecessary telephone requests from VA for current information.

b. In completing the status update, use the servicing update/remarks section to advise VA of servicing efforts, contacts made, arrangements made with the borrower, or special occurrences such as bankruptcy. If additional space is required, use the reverse side of the form or an additional sheet of paper. As with an NOD, a copy of the in-house servicing record is acceptable as long as it can be understood by VA. Figure 2-2 is an example of a properly completed VA Form 26-8778.

c. Holders should notify VA as soon as possible when a default is cured or a repayment plan is arranged. It is not necessary to wait for a status request from VA or to use a specific VA form.

## 2.09 Partial Payments (38 CFR 36.4315(b))

A partial payment is a remittance on a loan in default of any amount less than the full amount due under the terms of the loan which are in effect when the payment is tendered.

a. **Acceptance of Partial Payments**

(1) The holder must accept any partial payment except as provided in subparagraph b below. The holder must either apply it to the borrower's account or identify it with the borrower's account number and hold it in suspense pending disposition. When partial payments held for disposition add up to the full monthly installment, including escrow, they must be applied to the borrower's loan.

(2) Partial payments should not be processed routinely unless they are remitted under the terms of a forbearance/reinstatement plan. When one is received, even if it must be accepted pursuant to the regulation, the holder should contact the borrower to find out why only a partial payment was remitted and arrange for payment of the balance due to cure the default.

b. **Return of Partial Payments.** A partial payment may be returned to the borrower only if one of the following conditions exists:

(1) The property is wholly or partially tenant-occupied and rental payments are not being remitted to the holder for application to the loan account;

(2) The payment is less than one full monthly installment, including escrow and late charge, if applicable, unless a lesser amount has been agreed to under a written repayment plan;

(3) The payment is less than 50 percent of the total amount then due, unless a lesser payment amount has been agreed to under a written repayment plan;

(4) The payment is less than the amount agreed to in a written repayment plan;

(5) The amount tendered is in the form of a personal check and the borrower has been previously notified in writing that only cash or certified remittances are acceptable;

(6) A delinquency of any amount has continued for at least 6 months since the account first became delinquent and no written repayment plan has been arranged;

(7) Foreclosure has been commenced with the first action required for foreclosure under local law;

(8) The holder's lien position would be jeopardized by acceptance of partial payment; or,

(9) The VA office of jurisdiction has given prior approval to return partial payments received on the account.

The payment must be returned within 10 calendar days from the date of its receipt, accompanied by a letter of explanation.

## 2.10 Bankruptcy and Other Legal Proceedings (38 CFR 36.4319)

When a holder initiates suit or otherwise becomes a party in any legal or equitable proceeding in connection with a guaranteed loan, copies of all procedural papers must be provided to the VARO of jurisdiction. Failure to do so may result in partial or total loss of guaranty. This includes bankruptcy, partition suits, foreclosure by second lien holders, condemnation notices, etc. VA must receive the notice in time to respond to the proceeding as if VA were a direct party to the action. Timely submission of bankruptcy notices is especially important because failure to do so may result in establishment of a premature cut-off date (under 38 CFR 36.4319(f)) by VA. Bankruptcy notices should include a copy of the schedule of creditors, when available, because this information is useful for evaluating prospects for reinstatement of the loan and may provide an insight into the accuracy of the loan or assumption application, especially in a loan default within the first 2 years of origination or an approved assumption, .

## 2.11 VA Supplemental Servicing

a. **Purpose.** The primary responsibility for servicing delinquent loans rests with the loan holder. However, an aggressive program of personal supplemental servicing is conducted by VA to ensure that each veteran-borrower is afforded the maximum opportunity to continue as a homeowner during periods of temporary financial distress. VA also attempts, through supplemental servicing, to minimize losses to the Government as a result of foreclosure.

b. **Servicing Process**

(1) Upon receipt of an NOD, VA automatically sends the borrower a letter describing the various options for reinstating the loan or otherwise avoiding foreclosure. A similar letter is sent after VA receives an NOI or NOD&I. Copies of these letters appear in figures 2-3 and 2-4.

(2) VA personnel will attempt to contact the veteran-borrower by telephone in most cases to reinforce the seriousness of the default and determine if there is any way to resolve it other than foreclosure. In many cases, VA will recommend a specific repayment plan for the borrower to propose to the holder. Occasionally, VA will contact the holder directly to request forbearance or acceptance of a repayment plan. The VA loan service representatives involved in supplemental servicing are experienced in loan servicing and will base proposals for forbearance, repayment plans or alternatives to foreclosure on a detailed analysis of the borrower's financial situation and motivation.

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## CHAPTER 3. ALTERNATIVES TO FORECLOSURE

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# CHAPTER 3. ALTERNATIVES TO FORECLOSURE

## 3.01 Delinquent Loan Servicing Policy

VA, through personal supplemental servicing and guidance to loan holders, expects every realistic alternative to foreclosure which may be appropriate in light of the facts in each case to be explored before a loan is terminated by foreclosure. VA loan holders should expect to be contacted at various times during the course of a default by VA loan service representatives to discuss the case and will frequently be requested to assist in pursuing a specific alternative. Since alternatives to foreclosure generally result in either reinstatement of the account or a faster termination than would be obtained through foreclosure, they also benefit loan holders by reducing the possibility that interest accrual and foreclosure costs will create a "no-bid." Alternatives to foreclosure should be discussed with borrowers by the holder as soon as possible in the course of the default, preferably before legal action is initiated, to obtain the borrower's cooperation and minimize the chances that resolution of the default will be delayed by bankruptcy.

## 3.02 Forbearance

a. **Encouragement of Forbearance**

(1) It is VA's policy to encourage holders to extend reasonable forbearance in the event a worthy borrower is unable to begin an immediate plan to liquidate the delinquency.

(2) Forbearance is granted by allowing payments to remain delinquent for a reasonable time (usually not more than 12 months), to be followed by reinstatement of the loan through payment of a lump sum or a schedule of increased payments. For the typical default, a certain amount of forbearance is built into VA's default reporting requirements because the default may not be reported until 60 days after the date of first uncured default and foreclosure may not be initiated for 30 days after an NOI is received by VA. At any time in the servicing process, and especially once an NOD has been filed, holders should, as a matter of prudent servicing, obtain a written agreement with the veteran regarding the payment of the delinquency before granting forbearance beyond that which is built into VA's reporting requirements. The lack of a written agreement does not, however, prevent the holder from extending forbearance when it appears appropriate. The holder should inform VA of the forbearance and the reasons for it in the NOD and status updates. This information assists VA's supplemental servicing activity and can prevent the establishment of an inappropriate cutoff date.

b. **Predetermination of Net Value.** The holder may request an assurance from VA that should foreclosure become necessary VA will specify an amount at the foreclosure sale despite any decrease in value or increase in indebtedness that occurs during the period of forbearance. This predetermination of net value can only occur if:

(1) Foreclosure is imminent; and,

(2) The holder is willing to extend forbearance for a fixed period of time but is concerned that in the event of foreclosure VA may not specify an amount, which would expose the holder to a loss that would have been avoided by a prompt foreclosure.

Under these circumstances VA will make a net value determination, taking into account the period of forbearance, and advise the holder whether VA would specify an amount in the event of foreclosure.

## 3.03 Modifications-Extensions and Reamortizations (38 CFR 36.4314)

a. Modification involves a change of any of the terms of the original security instrument. Modification should be considered when the borrower's income has been curtailed and the borrower is financially unable to either maintain the payment at the current amount or to make up the delinquent payments, but will be able to keep the loan current after modification. Paragraph 1.06 discusses policies and procedures for extending or reamortizing a loan.

b. If the holder finds that modification is appropriate, but for some reason is unable to extend or reamortize the loan itself, it should notify VA so that refunding of the loan can be considered promptly (see par. 3.06). Refinancing a higher interest rate loan at a current, lower rate under VA's interest rate reduction refinancing program is also recommended in such cases. If the loan is current, no underwriting is necessary; if the loan is delinquent, VA can expedite prior approval of an application.

## 3.04 Sale of Property and Compromise Agreement

a. **Encouraging Sale of Property.** When borrowers are unable to maintain their mortgage payments, they should be encouraged to sell their homes at realistic prices to avoid foreclosure and salvage any equity they may have. Early counseling with borrowers about private sale can often help avoid loan terminations and reduce or eliminate losses to all interested parties. When the borrower has equity in the home, the holder should grant the borrower forbearance of reasonable duration to permit a sale.

b. **Proceeds Not Sufficient to Pay Indebtedness.** In some cases, because the property has declined in value or has not appreciated enough to cover repayment of a delinquency and the costs of sale, a private sale cannot take place without additional funding. VA will consider providing a "compromise claim" payment if an offer to purchase the property is received but the proceeds will not be sufficient to pay off the loan or to pay the delinquency in the case of an assumption. The sales price of the property should be the fair market value. In some assumption cases, where the fair market value is less than the unpaid principal balance of the loan, VA's compromise claim payment will also include funds to be applied as a prepayment to principal to reduce the loan balance to the amount the purchaser has agreed to assume. Any purchaser assuming a VA loan involving a compromise claim must be found by VA to be an acceptable credit risk and must agree to assume full legal liability for repayment of the loan and to indemnify VA against loss in

the event of a future default. If the sale is approved, VA will pay the holder a compromise claim for the difference between the net sales proceeds and the mortgage balance.

c. **VA Approval**

(1) VA must approve each compromise sale in advance. VAROs will generally require the following information prior to considering a compromise sale:

(a) A copy of the signed offer to purchase. The offer should include a contingency clause which reads, "This offer is contingent on VA approval of a compromise agreement."

(b) Estimated closing date.

(c) Statement of projected settlement costs.

(d) VA Form Letter 26-567, Status of Loan Account - Foreclosure or Other Liquidation.

(e) An appraisal or broker's estimate of value.

(f) If the loan is being assumed, a release of liability package must be completed by the seller and purchaser and submitted to the VA office of jurisdiction. Only VA, on a prior approval basis, can process an assumption and release of liability in cases involving compromise claim payments.

(2) VAROs will notify the holder and borrower when a compromise offer is tentatively approved and list the conditions of final approval. Generally, tentative approval is granted when the purchaser is determined to be acceptable from a credit standpoint and final approval is contingent upon execution of proper documents by the purchaser which evidence his or her legal liability to VA and for repayment of the loan. The notice will contain any necessary instructions regarding documentation and claim payment procedures.

d. **Compromise Claim**

(1) After the sale of the property has closed, the holder may claim payment from VA for the shortage as agreed. The following documentation is generally required to obtain payment. The VA regional office of jurisdiction will provide specific instructions.

(a) A certified statement of account (in effect, a certified copy of the ledger sheets or equivalent showing the amounts and dates of all debits and credits to the account).

(b) VA Form 26-1874, Claim Under Loan Guaranty, if required by the VARO. See paragraph 6.02 for more information on completing the form.

(c) Invoices for attorney fees and property preservation expenses.

(d) A copy of the settlement statement (HUD-1).

(e) A signed promissory note if the veteran is being required to repay VA for all or part of the compromise claim. (Some VAROs will obtain this independently; others require the holder to obtain it.).

(2) If the loan is being assumed, the following are also required:

(a) A copy of the recorded transfer deed and/or assumption agreement as required by the VA office of jurisdiction.

(b) The original guaranty certificate, which will be changed to reflect the claim payment and returned to the holder. (If the guaranty certificate is not available, or cannot be obtained from the document custodian, notify the VARO before proceeding with the sale so that alternative arrangements can be made.)

## 3.05 Deed in Lieu of Foreclosure (Voluntary Conveyance)

a. **General**

(1) When it is concluded that there is no alternative to terminating the loan, and a voluntary conveyance can be accomplished more quickly than a foreclosure, holders are strongly encouraged to explore the possibility of a deed in lieu of foreclosure.

(2) A voluntary conveyance may not be accepted without VA prior approval.

(3) Obtaining the deed must be legally feasible and the borrower must be willing to cooperate. A deed in lieu will usually not be accepted if there are any junior liens on the property. If the value of the property is substantially in excess of the debt, the borrower should be encouraged to sell the property rather than offer a deed. If the net value of the property does not exceed the unguaranteed portion of the indebtedness (which would result in a no-bid in the event of foreclosure, see par. 4.13), a voluntary conveyance will normally not be approved. In such cases, however, VA may approve a voluntary conveyance after the holder completes a partial debt waiver or reduction. If the holder does not intend to complete a partial debt waiver or reduction, VA may authorize the holder to accept a voluntary conveyance with no right to reconvey the property to VA. Such authorization is limited to cases when the borrower either will not be legally liable to reimburse VA for the claim paid or lacks the financial resources to do so.

b. **Consideration**

(1) The consideration for a deed in lieu of foreclosure is often a full and complete release of the mortgagor's personal liability. This should provide sufficient incentive for the borrower to execute the deed and also preclude any title questions.

(2) For legal purposes, avoidance of a recorded foreclosure and reduction of the liability amount may be a sufficient consideration. In some instances, where a complete release of liability

is not required by law or necessary to remove any potential cloud on title, the borrower may be required to agree to repay VA for all or part of the claim paid.

c. **VA Approval**

(1) The acceptance of a voluntary conveyance requires VA's prior approval. The holder should notify borrowers in writing that a deed in lieu of foreclosure is not acceptable until approved by VA. Borrowers should be advised to provide the loan holder with:

(a) A signed financial statement showing their assets, liabilities, income and expenses. (VA Form 26-6807 may be used.)

(b) A written statement requesting a deed in lieu of foreclosure and advising the reason for default, explaining why it is necessary to give up the security property and what efforts have been made to dispose of it, and an agreement to vacate the property when the deed is recorded or to give possession of the property to VA immediately upon notification to do so.

(2) Upon receipt of the borrower's financial and written statements, the holder should forward them and the following documentation to the VARO of jurisdiction.

(a) VA Form 26-6851, Notice of Intention to Foreclose, if not previously filed, indicating that a deed in lieu is obtainable.

(b) A statement of account (VA Form Letter 26-567).

(c) Occupancy status. If occupied, the name and telephone number of the occupant. If vacant, the keys properly identified with the VA LIN and property address.

(d) Title status. If information about any liens on the property which could affect the decision to accept a voluntary conveyance is available, it should be sent to VA.

(3) An appraisal must be ordered through VA. See paragraph 4.11.

(4) Upon receipt of advice that a deed is obtainable, the VARO will determine whether it is in VA's best interest to accept it. If acceptance is not approved by VA, the holder will be advised to proceed with foreclosure.

d. **Processing the Deed**

(1) If VA approves the deed, the holder and borrowers will be notified and provided further instructions. A cutoff date may be established to ensure the timely processing of the deed. If a cutoff date is established, it will usually be between 45 and 60 days after VA agrees to accept the deed. It may be extended if there are delays in obtaining the deed and related documents from the borrower(s), but extensive delay may cause VA to rescind the offer.

(2) An amount will normally be specified to be used as a credit to the indebtedness for the property. The holder will be paid the specified amount upon acceptance of the conveyance by VA. A claim will be paid for the balance of the eligible indebtedness and costs on the loan remaining after the specified amount has been credited. The following documentation is generally required to obtain payment.

(a) VA Form 26-8903, Notice of Election to Convey and/or Invoice for Transfer of Property, in triplicate, within 15 days after the deed is executed. See chapter 5.

(b) Original recorded deed from the borrower(s) to the holder and recorded deed from the holder to the Secretary of Veterans Affairs, or recorded deed from the borrower to VA.

(c) Estoppel affidavit in States where executing one eliminates or minimizes title questions. The VARO's instructions will indicate whether it is required.

(d) The executed promissory note from the obligor to VA (if required by the VARO as a condition for accepting the deed).

(e) Original mortgage documents and all recorded assignments.

(f) Title evidence in accordance with the VARO's instructions.

(g) VA Form 26-1874, Claim Under Loan Guaranty, signed by an appropriate official. See paragraph 6.02.

## 3.06 Refunding (38 CFR 36.4318)

a. **General**

(1) VA has discretionary authority to buy a loan in default from a holder and take over the servicing. Refunding is an optional action on the part of VA and does not provide borrowers with a right to refund their loans. Refunding is considered for each loan before foreclosure is completed, but there is no formal application process for use by borrowers or loan holders.

(2) The objective of refunding is to avoid foreclosure when it is determined by VA that the default can be cured through various relief measures and the holder is unable or unwilling to grant further relief.

b. **Procedure**

(1) **Information Needed.** When VA believes refunding might be in order, it will notify the holder and request that it:

(a) Send VA a statement of account (VA Form Letter 26-567).

(b) Order an appraisal of the property, if one has not already been ordered. See paragraph 4.11.

(2) **Notification.** If VA decides to refund a loan, the holder will be immediately notified and given further instructions. A notice will also be sent to the borrower.

(3) **Settlement.** VA will set the date of settlement, which generally will not exceed 60 days from the date of VA's formal notice of intent to refund. The VARO of jurisdiction will provide instructions to obtain payment on the loan. Generally the following documents will be required:

(a) VA Form 26-1874 signed by an appropriate official. In item 4, Date of Loan Termination, enter the settlement date and indicate that the loan is to be refunded. See paragraph 6.02.

(b) Certified copy of the loan ledger or history.

(c) Unrecorded assignment of mortgage.

(d) Original note, endorsed to the Secretary of Veterans Affairs.

(e) Hazard insurance policy with a copy of the endorsement request.

(f) Original mortgagee's title policy, naming the Secretary of Veterans Affairs as a co-insured.

(g) Original survey of the property.

(h) Current tax receipts.

(i) Other documents specifically required in instructions issued by the VARO.

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## CHAPTER 4. TERMINATION BY FORECLOSURE

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# CHAPTER 4. TERMINATION BY FORECLOSURE

## 4.01 Preforeclosure Analysis

a. A decision to foreclose must be based on an analysis of the individual loan with full knowledge of the alternatives and consequences to all parties to the loan. Foreclosure should not be automatic. The purpose of the preforeclosure analysis is to gain a thorough understanding of the nature and reasons for the default and the prospects for curing it, and to determine what action might avoid foreclosure.

b. The analysis should include a careful search for alternatives, including the determination whether some other party might act to avoid foreclosure. The possibilities include relatives, co-makers, Government welfare agencies, secondary lien holders, previous owners not released from personal liability, or the borrower's employer.

c. A preforeclosure review should be carefully documented. Holders should be sure the following was done:

(1) VA regulations pertaining to accepting partial payments were followed.

(2) A face-to-face interview was conducted or meaningful telephone contact made. Only with adequate information about the borrower can a proper foreclosure decision be made. If no contact was made, the efforts to contact the borrower should be well documented.

(3) VA servicing and reporting requirements were satisfied.

(4) Relief measures were considered and offered as applicable.

(5) Notice of a transferee owner's default was sent to the original veteran-borrower's last known address.

## 4.02 Foreclosure Recommendation

The recommendation of foreclosure should be made by the loan counselor handling the account, and be carefully reviewed by supervisory or management personnel.

## 4.03 Cutoff Date-Application of 38 CFR 36.4319(f)

a. **Minimizing the Loss to the Government.** VA encourages holders to extend every reasonable indulgence to worthy borrowers who are in temporary difficulty. However, when it is evident that the default is insoluble, every effort should be made to see that the security is liquidated promptly to minimize the loss to the Government.

b. **An Insoluble Default.** VA will consider any loan with 6 or more installments due and unpaid to be an insoluble default unless the holder has informed VA that a repayment plan is in effect or that forbearance is being granted for some other reason. VA may also learn through its supplemental servicing efforts that the borrower cannot or will not be able to cure the default in the foreseeable future.

c. **Establishment of a Cutoff Date**

(1) Once VA determines that a defaulted loan is insoluble, it will protect its interest by establishing a cutoff date for the computation of a claim under the guaranty, as provided by 38 CFR 36.4319(f). A claim paid under Loan Guaranty will exclude interest and most charges, other than liquidation costs, which accrue or are incurred after the cutoff date. The holder will be advised by registered mail of the establishment of a cutoff date.

(2) The cutoff date will be the date liquidation should be completed if the holder initiates appropriate action within 30 days of the date of the cutoff letter. VA considers referral to counsel to initiate public legal action to terminate the loan to be appropriate legal action for purposes of establishing a cutoff date. If a bankruptcy court has stayed the termination, appropriate action is referral to counsel to obtain relief from the automatic stay, to be followed by prompt legal action to terminate the loan. In bankruptcy cases, the cutoff date will include additional time for the holder to have the stay removed; the amount of time allowed will vary between VA offices based on their experience with the local bankruptcy courts, but generally will be 3 months after the filing date for Chapter 7 cases and 5 months for Chapter 13 cases in which no payments are received from the borrower or the trustee.

(3) A cutoff date will also be established if the holder initiates termination action timely but fails to prosecute the action with reasonable diligence. It will be based on the time normally required to complete termination from the date the initial referral to counsel was made by the holder.

(4) Appendix E contains the cutoff timeframes used by VA regional offices as of the date of publication of this handbook. These timeframes cover the period from referral to counsel until foreclosure is completed through either the sale or confirmation of sale, depending on the jurisdiction. They are for routine, uncontested, foreclosures. VA regional offices may change these timeframes based on changes in local foreclosure procedures or practices.

d. **Adjustment of a Cutoff Date.** The cutoff date can be adjusted if the holder shows that further forbearance was justified or that delay in liquidation was beyond its control. Errors or delays by the holder's counsel are considered to be within the holder's control since counsel acts as the agent of the holder. The cutoff date will be automatically adjusted if any payments are received and accepted by the holder after the cutoff date was established. Holders may request reconsideration and adjustment of a cutoff date at any time prior to payment of a claim by VA. However, once a cutoff date has been established, VA will usually review and (if appropriate) adjust it only at the time bidding instructions are prepared or at the time the claim is being paid. The current cutoff date will be shown on any specified amount letter issued by VA.

## 4.04 Guaranty Computation and Cutoff Dates-Application of 38 CFR 36.4321

a. **General**

(1) This regulation has two primary purposes. The first is to define the maximum amount payable under VA's guaranty. The second is to prevent cases in which VA is unable to specify an amount solely because the loan indebtedness increased during a period of undue delay in loan termination caused by VA or the borrower.

(2) For each GI loan, the Loan Guaranty Certificate states both a percentage and a dollar amount of guaranty. The dollar amount of guaranty is equal to the percentage of guaranty as applied to the original loan amount. When a claim is payable, VA's maximum guaranty liability is the lesser of:

(a) The dollar amount of guaranty; or,

(b) The percentage of guaranty applied to the eligible indebtedness as of the liquidation sale date or a cutoff date established under 38 CFR 36.4319(f) or 36.4321(b), whichever is earliest.

(3) The eligible indebtedness is defined in 38 CFR 36.4301 as the unpaid principal plus accrued interest plus any advances or charges, allowable under the terms of the loan and actually incurred, which are authorized by statute and consistent with VA regulations. Late charges are excluded and funds applicable to the account, such as a positive escrow or suspense balance, are credited in the computation of the indebtedness.

(4) If a liquidation sale is delayed by more than 30 days as a result of a voluntary bankruptcy filed by the borrower, or forbearance requested by VA and granted by the holder, and:

(a) As of the revised liquidation sale date or the revised 38 CFR 36.4319(f) cutoff date (whichever is earlier) VA would be unable to specify an amount for credit to the indebtedness because the indebtedness increased during the interval; and,

(b) As of a date 30 days after the date VA determines the liquidation sale would have taken place, if there had been no delay due to bankruptcy or VA-requested forbearance, the unguaranteed portion of the eligible indebtedness is less than the net value of the property (i.e., VA would be required to provide the holder with a specified amount for credit to the indebtedness); then,

An adjusted cutoff date will be established under 38 CFR 36.4321(b)(1) (if the delay is due to forbearance) or 36.4321(b)(3) (if the delay is due to bankruptcy), and VA will advise the holder of the specified amount. The adjusted cutoff date will be 30 days after the date that the liquidation sale would have been held if there had been no delay.

(5) In other cases in which the liquidation sale is delayed by VA (generally those in which VA does not provide the holder with net value advice within 2 working days prior to a scheduled liquidation sale) and the delay would change a specified amount to a no-bid, VA will avoid the no-bid by using the date the sale should have been held for purposes of computing the eligible indebtedness. However, for purposes of claim computation, the actual liquidation sale date will be used. In such cases, the claim payable may not exceed the maximum guaranty plus the cost of the liquidation appraisal.

b. **Eligible Forbearance**. Generally, the terms of a repayment plan provide for liquidation of the arrears and payment of the regular monthly installment in accordance with a fixed schedule. Forbearance refers to cases in which the holder agrees to accept no payments or payments which are less than a monthly installment for a fixed period of time based on the probability that the borrower will be able to cure the default or begin a repayment plan at the end of that period. When a holder agrees to grant forbearance at VA's request, the holder should document the terms of the forbearance by letter. If the loan is not reinstated, and no amount is specified by VA in connection with a subsequent foreclosure sale, provisions of 38 CFR 36.4321(b) may be accurately applied. VA expects holders will generally provide borrowers with written notice of forbearance. A copy of this notice is adequate documentation.

c. **Effect on Claim Analysis.** Cutoff dates established as a result of bankruptcy or VA-requested forbearance will generally also apply in the computation of the holder's claim under guaranty. However, for purposes of VA's claim analysis, the account must be credited with any payments received after the cutoff date. The date of first uncured default and the cutoff date will be adjusted to account in the claim analysis. For example: Assume VA specified an amount in connection with a sale scheduled for January 1, but the sale was delayed until November 1 due to a Chapter 13 bankruptcy and, as of November 1, no amount would be specified. If an amount is specified based on the indebtedness as of January 31, VA would establish January 31 as the cutoff date and issue net value advice. If three installment payments were received under the bankruptcy, VA would credit them to the account and move the cutoff date forward to May 1 for purposes of claim computation.

## 4.05 Filing VA Form 26-6851, Notice of Intention to Foreclose (38 CFR 36.4317)

a. **When to File.** The holder should first exhaust all reasonable efforts to effect a cure of the default. The notice should be filed after:

(1) The loan is delinquent for 3 months (38 CFR 36.4316), and

(2) The default is determined insoluble.

In exceptional circumstances, such as a hazard to the security or material prejudice to the holder's rights or to VA, the notice may be filed earlier. When a loan is more than 30 days delinquent, a property abandonment must be reported to VA and liquidation action initiated within 15 days after

the holder confirms the property is vacant. Referral to an attorney to begin foreclosure constitutes initiation of liquidation action.

b. **Filling Out the NOI**

(1) The NOI must be sent by registered or certified mail with return receipt requested. Figure 4-1 is an example of a properly completed NOI.

(2) In filling out the NOI, holders should pay special attention to the following:

(a) **VA LIN (VA Loan Identification Number)** The VA LIN must be numeric and 12 digits in length. See appendix B for instructions.

(b) **Holder's Name, Address, and Telephone Number (Item 1A)** Provide a telephone number so VA loan service representatives can contact the holder's personnel directly.

(c) **Original Veteran's Name and Present Address (Item 2)** If someone other than the original veteran is the present owner, the name and current address of the original veteran should be provided. For purposes of the NOI, the original veteran's name is required by 38 CFR 36.4332. His or her current address should be the most recent available in the holder's system of records. (After a notice of intention to foreclose is filed, holders must make an effort to determine the original veteran's current address (see par. 4.07)). Because veterans may be held liable to reimburse the Government for claims paid due to transferee defaults, VA requires this information to try to provide veterans with notice of transferee defaults. In some areas, generally those in which foreclosure cannot be completed quickly, it is not essential that VA have this information at the time the NOI is filed. Since many holders do not retain data on prior obligors in their automated servicing records, each VA office of jurisdiction has issued a release informing holders whether or not they must strictly adhere to this regulatory requirement.

(d) **Other Transferee Data (Item 7)** If item 6 is checked "yes," provide the names of those who held title to the property other than the original veteran and the current property owner. If the transferee's address, name of employer and address of employer are not on record, type "unknown" in the appropriate blocks.

(e) **Voluntary Conveyance Data (Item 11)** Holders often neglect to check the appropriate block to indicate whether or not a voluntary conveyance is obtainable. Usually, through personal contact, the holder can determine whether there are any secondary liens which encumber the property that would preclude a voluntary conveyance. Check whether such a deed is feasible.

(f) **Holder's Loan Servicing (Item 12)** It is important that VA have complete information about the reasons for the default and decision to foreclose. This space also provides the holder with the opportunity to document the quality of its servicing by showing that it has discussed alternatives to foreclosure with the borrower and to indicate the borrower's responsiveness. Use the back of the NOI or a separate sheet of paper if more space is needed. A narrative summary of any contacts made with the borrower since filing the NOD is also useful. If no contact was made,

give a history of the attempts made. What alternatives to foreclosure were suggested? Which appear feasible? Why are some not feasible? A copy of the in-house servicing record is acceptable as long as the VARO has been provided with instructions on how to read it and explanations of any abbreviations it contains.

(g) **Occupancy Data (Item 13).** Report who is occupying the property, or if it is vacant, where the keys may be obtained and whether the property has been secured.

(h) **Signature (Item 15).** The form must be signed by a corporate officer or other authorized full-time employee of the holder or its servicing agent. If the proper signature is omitted, the form will be returned.

## 4.06 Filing VA Form 26-6850a, Notice of Default and Intention to Foreclose (38 CFR 36.4317)

a. **When to Use the NOD&I.** The NOD&I allows the holder to simultaneously notify VA that a loan is in default, the default is insoluble, and that it intends to proceed with foreclosure. This form may be used if:

(1) The property is abandoned.

(2) It is determined that the loan is insoluble before the NOD is filed.

(3) Delay in termination action may expose the security to waste or hazard or may cause material prejudice to the rights of the holder or VA.

b. **Waiver Request.** If appropriate, the holder should request a waiver of the 30-day waiting period before initiation of legal action (38 CFR 36.4317).

c. **Completing and Sending the NOD&I.** The NOD&I must be sent by registered or certified mail with return receipt requested. Figure 4-2 contains an example of a properly completed NOD&I. In filling out the NOD&I, holders should pay special attention to the following:

(1) **VA LIN (VA Loan Identification Number) (Item 3)** The VA LIN must be numeric and 12 digits long. See appendix B for instructions on constructing the VA LIN.

(2) **Holder's and Servicing Agent's Phone Number (Item 6)** Provide a telephone number so VA loan service representatives can contact the holder's personnel directly.

(3) **Date of First Uncured Default (Item 9).** This is the due date of the first or earliest partially or fully unpaid installment.

(4) **Present Owner's Social Security Number (Item 10)**

(5) **Original Veteran's Name and Present Address (Item 16)** If the default occurs when someone other than the original veteran is the present owner, the name and current address of the original veteran should be provided. See paragraph 4.05b(2)(b).

(6) **Occupancy Data (Item 20)**. Report who is occupying the property, or if it is vacant, where the keys may be obtained and whether the property has been secured.

(7) **Other Transferee Data (Item 21)**. Provide the names of anyone who held title to the property after the original veteran and before the current property owner. If the transferee's address, name of employer and address of employer are not on record, type "unknown" in the appropriate blocks.

(8) **Voluntary Conveyance Data (Item 23)**. Holders often neglect to check the appropriate block to indicate whether or not a voluntary conveyance is obtainable. Usually through personal contact the holder can determine whether there are any secondary liens which encumber the property that would preclude a voluntary conveyance. Check whether a deed is feasible.

(9) **Present Owner's Telephone Number (Items 27E and 27F)** A diligent effort should be made to obtain the telephone number of both the property owner's place of employment and home. If a number is not available, note in the servicing summary what efforts have been made to obtain the number. This will prevent the duplication of effort when VA begins supplemental servicing.

(10) **Reason for Default and Summary of Loan Servicing (Item 28)** It is important that VA have complete information about the default and the prospects for resolution. Use the back of the NOD&I or separate sheet of paper if more space is needed. Provide a summary of contacts made with the borrowers or the attempts made if there was no contact and the reasons for filing a combined NOD and NOI. A copy of the in-house servicing record is acceptable as long as the VA regional office has been provided with instructions on how to read it and explanations of any abbreviations it contains.

(11) **Signature (Item 30)**. The form must be signed by a corporate officer or other authorized full-time employee of the holder or its servicing agent. If the proper signature is omitted, the form will be returned. The individual signing the notice should review the form to see that the information provided is accurate.

## 4.07 Notice to Original Veteran-Borrower and Other Liable Obligors

(38 CFR 36.4317)

a. A notice of intention to foreclose must also be sent to the original veteran-borrower, if still a liable obligor, and any other liable obligors when the current owner of the property is not the original veteran-borrower. The notice must be sent by registered mail within 30 days after such notice is provided to VA. A failure by the holder to make a good faith effort to comply with these requirements may result in a partial or total loss of guaranty. A good faith effort will include, but is not limited to:

(1) A search of the holder's automated and physical loan record systems to identify the name and current or last known address of the original veteran and any other liable obligors;

(2) A search of the holder's automated and physical loan record systems to identify sufficient information (e.g., Social Security Number) to perform a routine trace inquiry through a major consumer credit bureau;

(3) Conducting the trace inquiry using an in-house credit reporting terminal;

(4) Obtaining the results of the inquiry;

(5) Mailing the required notices and concurrently providing VA with the names and addresses of all obligors who have been identified and notified; and,

(6) Documentation of the holder's records.

b. VA will reimburse the holder $10 in its claim under guaranty, as a liquidation expense, for each obligor subject to this procedure.

## 4.08 Starting Liquidation Proceedings

a. **30 Day Delay Before Starting Foreclosure** (38 CFR 36.4317)

(1) The NOI or NOD&I must be filed at least 30 days prior to starting any action to liquidate the security for the loan. Failure to give proper notice of foreclosure may result in an adjustment in the amount of the claim payable if it increased VA's liability.

(2) If the circumstances warrant immediate action to protect the interest of the holder and VA (such as abandonment of property), the holder may take action without advance notice. In such instances the holder must promptly notify VA of the action taken. Except in cases of abandonment, VA would prefer that when warranted, the holder file a NOI or NOD&I in advance of initiating foreclosure action and request waiver of the 30-day waiting period. If waiver is warranted, VA will immediately respond by giving approval to begin foreclosure action.

b. **Election of Liquidation Procedure.** (38 CFR 36.4324(f)) VA will notify the holder within 15 days of receipt of the NOI if it requires the holder to act to preserve the personal liabilities of the obligors. Otherwise, the holder may elect any available liquidation procedure.

c. **Persons in Possession of Property.** The holder should make persons in possession under a claim of title parties to any judicial foreclosure proceedings and cause them to be properly served. In nonjudicial foreclosure the holder should take any feasible legal steps available under local law, by notice or otherwise, to prevent the rights of any such persons from surviving the foreclosure to ensure VA will be provided with acceptable title after foreclosure.

## 4.09 Other Notices to VA (38 CFR 36.4319)

Holders must notify the appropriate VARO of any steps contemplated or action taken in connection with the liquidation of the security. A copy of every procedural paper filed on behalf of the holder and of each pleading served on the holder must be sent to VA.

## 4.10 Reinstatement of Defaulted Loans (38 CFR 36.4308(h))

a. **Acceptance of Funds.** If sufficient funds are tendered to bring a defaulted loan current at any time prior to a sale to liquidate the security for a guaranteed loan, the holder must accept the funds in payment of the delinquency unless:

(1) The prior approval of VA is obtained to do otherwise, or

(2) Reinstatement of the loan would adversely affect the dignity of the lien or is otherwise precluded by law.

b. **Definition of the Delinquency.** The delinquency will include:

(1) All installment payments (principal, interest, taxes, insurance, advances, etc.) due and unpaid.

(2) Any accumulated late charges.

(3) Any reasonable expenses incurred and paid by the holder if termination proceedings have begun (e.g., advertising costs, foreclosure costs, attorney or trustee fees, recording fees, appraisal costs).

## 4.11 Liquidation Appraisal

a. **Ordering the Appraisal.** At least 30 days before the foreclosure sale date (sooner, if the VARO has issued instructions requiring or permitting it to be ordered earlier), the holder must request from the appropriate VARO the assignment of an appraiser to determine the fair market value of the security. Holders should fill out VA Form 26-1805, VA Request for Determination of Reasonable Value/HUD Application for Property Appraisal and Commitment, and forward all copies except 1 and 2 to the assigned appraiser.

b. **Assisting the Appraiser.** Holders must assist the appraiser in gaining interior access to the property unless prohibited by local law. If the property is occupied, the appraisal request must include the name and number of current or last known occupants. If the property is vacant, keys should be given to the appraiser or other arrangements made for access. If the holder fails to assist the appraiser to obtain access and the foreclosure sale has to be postponed, 38 CFR 36.4319(f) may be invoked and a cutoff date established to limit the liability of VA.

c. **The Appraisal Fee.** The holder will pay the appraisal fee, which may be included as a liquidation cost in the claim. Each VARO sets the amount of the liquidation appraisal fee for its jurisdiction. After the appraisal has been ordered, the fee should be included in the amount of the delinquency if the borrower wishes to bring the loan current.

## 4.12 Notice of Sale (38 CFR 36.4319(b))

A copy of a notice of liquidation sale must be delivered to VA at least 30 days prior to the scheduled foreclosure sale or within 5 days of the first publication date, whichever is later. The notice must be accompanied by a copy of the liquidation appraisal request, VA Form 26-1805 and a statement of account, VA Form Letter 26-567, if these documents have not previously been delivered. See figure 4-3 for an example of a properly completed VA FL 26-567, Status of Loan Account - Foreclosure or Other Liquidation.

## 4.13 Bidding Instructions (38 CFR 36.4320)

a. **General.** A foreclosure sale should not be held unless the holder has received instructions from VA. Normally, a letter of instruction will be sent in time to be received by the holder at least two working days prior to the date of the scheduled foreclosure sale. When time does not permit mailing instructions, VA will give instructions by telephone or electronic media, and confirm by letter. If the holder does not receive notification, it should contact the VARO in advance of the scheduled foreclosure sale.

b. **Total Indebtedness**

(1) When the net value of the loan security exceeds the total indebtedness (debt plus costs), the holder will be instructed by VA Form Letter 26-639, Specified Amount Letter (fig. 4-4) that the credit to the indebtedness on account of the sale must be the total indebtedness.

(2) When total indebtedness is specified, the holder should calculate the indebtedness to the foreclosure sale date or the cutoff date established under 38 CFR 36.4319(f), including allowable foreclosure costs and expenses (see par. 4.17), and bid that amount at the sale. When instructions are received verbally, the holder should make certain they are accompanied by any revision to the cutoff date. There will be no claim payable by VA when total indebtedness is specified and the property is bought by a third party or retained by the holder. If the property is conveyed to VA, the unpaid principal balance will be paid for transfer of the property. A final accounting with VA after title is accepted, using VA Form 26-1874, Claim Under Loan Guaranty, must be received and analyzed before the balance of the indebtedness is paid.

c. **VA Specified Amount**

(1) When the net value of the loan security is greater than the unguaranteed portion of the indebtedness but is less than the total indebtedness, VA will advise the holder to credit to the indebtedness on account of the sale a specific dollar amount. This amount will be equal to the net value of the security to VA.

(2) If an amount is specified, advice to the holder will be given by VA Form Letter 26-639 (fig. 4-5). The holder should not bid more than the specified amount at the foreclosure sale unless the holder desires to keep the property. If the holder bids in excess of the specified amount, the accounting with VA will be based on the bid, and the holder will not have the option of conveying the property to VA (see par. 4.14). If the holder allows a third party to acquire the property with a bid of less than the specified amount, it will lose the difference between the successful third party bid and the specified amount.

d. **No Specified Amounts (No-Bids)**

(1) When the net value of the loan security is less than the unguaranteed portion of the indebtedness, VA will not specify an amount for the holder to credit to the indebtedness on account of the sale and will not accept conveyance of the property.

(2) If no amount is specified by VA, a bid in excess of the indebtedness (including allowable foreclosure expenses) less the amount payable under the guaranty may reduce the amount of claim payable by VA. The net value of the property is stated by VA in the no-bid advice letter. Holders should be cautious about bidding in excess of the net value, unless they wish to ensure they acquire the property, because such a bid may exceed the unguaranteed portion of the indebtedness and reduce the amount of claim payable by VA.

e. **Partial Waiver of Indebtedness to Obtain a Specified Bid (No-Bid Buydown)**

(1) **Procedure**

(a) Upon receipt of advice that no amount will be specified for credit to the indebtedness, the holder may waive or satisfy a portion of the indebtedness to reduce it to an amount which would require VA to provide a specified amount and acquire property under 38 CFR 36.4320. The waiver may take the form of a reduction of the principal balance, credit to escrow or the unapplied funds account, forgiveness of unpaid accrued interest or a combination of these credits.

(b) VA has two legal concerns about partial debt waivers or reductions. The holder's action must not affect the validity of the foreclosure or the validity of the indebtedness which may be established against the obligors and must be binding on all parties to the loan agreement and documented by appropriate entries to the account ledgers. It cannot be rescinded without the approval of all parties to the loan agreement. Subject to these concerns, VAROs will determine the debt reduction procedure(s) acceptable in their jurisdiction and will make this information available upon request.

(2) **Adjustment of Cutoff Dates.** VA regulations require that the indebtedness as of the cutoff date be used for determining VA's guaranty liability and for determining whether or not an amount will be specified for credit to the indebtedness on account of a foreclosure sale. There will be occasions when the holder is not advised that no amount will be specified until after a cutoff date has passed. In such cases, the holder would be effectively denied the opportunity to reduce the indebtedness to obtain a specified amount from VA. To give the holder the opportunity to reduce the indebtedness, any advice to a holder that no amount will be specified by VA will be accompanied by a statement to the effect that the existing cutoff date will be rescinded and replaced by a revised cutoff date, which will be 30 days from the date of the advice. Consideration will be given to extending the 30 day limit to 60 days when holders advise VA that additional time is necessary for them to secure required approvals for debt reduction or when local law does not permit rescheduling the sale within 30 days.

## 4.14 Overbids at Foreclosure Sales (38 CFR 36.4320(a)(1)(ii)(B))

a. If an amount was specified, and the holder acquires the property at the liquidation sale for an amount in excess of the specified amount, the indebtedness must be credited with the proceeds of the sale. The holder will not have the option to convey the property to VA.

b. In some States, the holder can legally amend the amount bid at a sale or set aside or vacate the sale. Holders should consult with the appropriate VARO and their own counsel regarding possible methods to correct an overbid. Notice of all legal actions must be provided to VA (38 CFR 36.4319(a)).

c. If a new sale is scheduled, the date of the first sale will be the cutoff date for the purposes of claim computation. The procedures for providing notice of sale (par. 4.12) and ordering a liquidation appraisal (par. 4.11) should be followed so that appropriate advice can be provided by VAROs in a timely manner.

## 4.15 Property Preservation

a. A holder is responsible for measures needed to protect and preserve the security for the loan, especially when the property becomes vacant. This responsibility ends when VA accepts custody of the property after receiving the holder's VA Form 26-8903, Notice of Election to Convey and/or Invoice for Transfer of Property.

b. The property must be inspected at least once a month after liquidation proceedings have been started, unless servicing information shows the property has remained owner-occupied (see par. 2.04, Property Inspections). VARO releases describe the measures to be taken in securing vacant properties and the maximum expenses allowed.

c. VA must be notified of any damage to the property or if it is abandoned, especially after the bidding instructions have been sent. (38 CFR 36.4320(e))

## 4.16 Deficiency Judgment

Unless a personal deficiency judgment is routinely obtained incident to the foreclosure, VA requires the holder to obtain one only when it is necessary to preserve the personal liability of the obligors and VA has requested the holder to do so upon receiving the notice of intention to foreclose. In such cases, VA will allow the cost of obtaining a deficiency judgment to be included in the claim. In other cases, the holder may also obtain a deficiency judgment at its own expense to protect its interests provided foreclosure is not delayed.

## 4.17 Acceptable Expenses (38 CFR 36.4313(b))

a. The following expenses may be included in any accounting with VA, and in the computation of a claim under the guaranty, if authorized by the loan agreement:

(1) Any expense reasonably necessary for preservation of the security. VARO releases list the maximum amounts that will be reimbursed for various property preservation measures in their area, including property inspections.

(2) Court costs in a foreclosure or other prior judicial proceeding involving the security.

(3) Other expenses reasonably necessary for collecting the debt or liquidation of the security, including preliminary title and tax search costs which are not considered part of the attorney or trustee's fee and are not included in the cost of title evidence allowable under 38 CFR 36.4320(f)(2).

(4) Reasonable trustee's fees or commissions not in excess of those allowed by statute and in no event in excess of 5 percent of the unpaid indebtedness.

(5) A reasonable amount for legal services actually performed, as determined by the VA office of jurisdiction. In no event may this amount exceed 10 percent of the unpaid indebtedness as of the date of the first uncured default, or $700, whichever is less.

(6) Reasonable and customary costs of property inspections.

(7) Any other expense or fee that is approved in advance by VA.

b. The total amount of trustee's fees and legal services may not exceed $700 unless prior approval for a higher figure has been granted by the VARO. Such approval will normally only be granted for services which are uniquely necessary because a VA-guaranteed loan is the subject of the litigation. VA does not allow legal fees in connection with a bankruptcy, but will reimburse the holder up to $100 for each court appearance made by counsel in connection with the action. The number of appearances and the fees paid must be documented with the holder's claim.

c. As noted in paragraph 4.07, a charge of $10 for each prior obligor who must be provided with notice of the holder's intention to foreclose may also be included in the claim.

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## CHAPTER 5. CONVEYING REAL PROPERTY TO VA

**PARAGRAPH** **PAGE**



**Figure**

# CHAPTER 5. CONVEYING REAL PROPERTY TO VA

## 5.01 Background

a. Prior to the liquidation sale of a VA-guaranteed loan, holders receive advice from VA on how to proceed and whether the holder will have the opportunity to convey the property to VA. This is accomplished through the form letters described in paragraph 4.13, which are commonly referred to as either "bid (specified amount or net value) letters" or "no-bid letters." These letters require the holder to credit the account indebtedness with the specified amount for purposes of accounting with VA, even if a lesser amount is bid at the foreclosure sale. If a greater amount is bid, the account must be credited with the net proceeds of the sale.

b. If VA specifies an amount for the holder to bid at the liquidation sale or instructs the holder to bid the total indebtedness, the holder can convey the property to VA as long as the bid at the sale does not exceed the specified amount. Payment for the property will be authorized when evidence of acceptable title is approved by VA. The holder will be sent a letter at that time indicating when it should expect to receive payment. As consideration for the conveyance, VA will pay the holder:

(1) The specified amount; or,

(2) The total eligible indebtedness, if VA advised the holder to credit the total indebtedness on account of the sale. This type of bid letter is commonly referred to as a "debt plus costs" or "total debt" letter.

## 5.02 Custody Retained by the Holder

Holders normally convey property to VA after a loan has been liquidated. However, there are five reasons that holders retain title:

a. The holder chooses to do so;

b. VA issues "no-bid" advice which precludes the holder from conveying the property to VA;

c. A failure to follow the regulations which form the basis of VA's guaranty (e.g., notice of election to convey the property is not received by VA within 15 days after the sale, bid at the sale exceeded the net value of the property);

d. Acceptable evidence of title cannot be provided; and/or,

e. Acceptable evidence of title is not provided timely.

## 5.03 Condominiums (38 CFR 36.4320(h)(10))

A condominium may be conveyed to VA only if the property, including the elements of the development or project owned in common with other unit owners, is undamaged by fire, earthquake, windstorm, flooding or boiler explosion. VA may agree to accept conveyance of a damaged condominium if repairs are completed within a given period of time.

## 5.04 Transfer of Custody to VA

a. **VA Form 26-8903, Notice for Election to Convey and/or Invoice for Transfer of Property.** When a holder has the option to convey liquidated property to VA and chooses to do so, the holder must notify VA on VA Form 26-8903 in triplicate. An example of a completed Notice of Election to Convey appears in figure 5-1. The notice must be received not later than 15 days after the date of sale or confirmation of sale. To facilitate processing of the conveyance, VA generally provides a partially completed VA Form 26-8903, together with instructions as to the title documentation which will be required, along with the specified amount letter.

b. **Acceptance of Custody.** VA will accept custody of the property upon receipt of this form unless the holder specifically requests to retain custody until conveyance of the property is approved. If VA has not processed receipt of VA Form 26-8903, the holder will be mailed VA Form 26-8802, Request to Lender for Results of Foreclosure - LCS, which requests the results of the foreclosure sale, 30 days after the scheduled sale date. The holder should immediately check its records to verify that custody has been transferred to VA and contact the VA office of jurisdiction to confirm whether or not the notice has been received. Conveyance will not be accepted until the title package is reviewed and approved. Upon acceptance of the holder's conveyance or transfer, VA will pay the consideration for the property.

c. **Risk of Loss.** (38 CFR 36.4320(h)(10)) The holder remains responsible for loss due to property damage or personal injury at the property from the date it acquires the property until risk of loss is assumed by VA. Assumption of the risk of loss by VA usually occurs when VA receives the holder's VA Form 26-8903 and accepts custody. At this time the holder should discontinue all property management functions unless it is retaining custody.

## 5.05 Title

a. **Designation of Grantee.** Conveyances to VA should be made out to the "Secretary of Veterans Affairs, an Officer of the United States of America, successors and assigns, at (VA office of jurisdiction address)." This language may be modified so long as the form of the modification is legally acceptable in the area. Care must be taken to ensure the office of jurisdiction's address is used.

b. **Conveyance by General Warranty.** (38 CFR 36.4320(h)(5)(ii)) In most areas, a supervised lender or a holder of financial responsibility satisfactory to VA may convey property to VA with a general warranty deed instead of providing evidence of acceptable title. When a general warranty is tendered (either in the conveyance or by separate instrument), the conveyance will be accepted and placed on record immediately and title examination will not be required. The holder must still deliver to VA the title evidence it has.

c. **Conveyance with Special Warranty and Acceptable Title Evidence**

(1) **Special Warranty.** When a general warranty is not used, the conveyance will be with "special warranty" only. The grantor covenants (or "warrants") in the deed or by separately executed instrument against any claim to the property, or any interest therein, adverse to grantee (Secretary of VA) by such grantor (transferor) and by any person or persons claiming through or under it.

(2) **Acceptable Title Evidence** (38 CFR 36.4320(h)(5))

(a) Title to any real property conveyed to VA must be of the same quality as the title generally required by prudent lenders, informed buyers, title companies, and attorneys in the community where the property is located. The definition of acceptable title evidence may vary from State to State. Each VARO has issued a release describing the title evidence and documents required in its jurisdiction. Holders should receive a copy of these instructions with the bid letter when the holder has an opportunity to convey the property to VA.

(b) In most areas of the country, loan holders may submit title policies as acceptable title evidence and transfer deeds when transferring title of property to VA. VA encourages use of this procedure whenever it will facilitate the title approval process.

(3) **Cost of Title Evidence.** The customary cost of title evidence will be borne by VA. The costs may not exceed the rates charged generally by local title companies. In certain areas VA may save time and expense by making arrangements with title insurers or others for furnishing title policies or other evidence of title. Holders will be notified of the arrangements and should use such sources to obtain the required title evidence. If the VA office of jurisdiction has negotiated a reduced fee for title evidence from one or more specific companies, holders will only be reimbursed at the negotiated rate unless a persuasive argument can be made for the need to obtain higher cost evidence.

(4) **Quality of Title** (38 CFR 36.4320(h)(5))

(a) Encroachments, easements, restrictions with or without condition of reverter, and other matters enumerated in the regulations (38 CFR 36.4350(b)) will not constitute objections to the acceptance of title. However, if these items were not taken into account in determining the reasonable value at loan origination, an adjustment of the claim may be made.

(b) When the property is to be conveyed, there must not have been a breach of any of the conditions affording the right to the exercise of any reverter. However, title will not be unacceptable to VA by reason of a violation of a restriction based on race, color, religion, sex or national origin, even if the restriction provides for revision or forfeiture of title or a lien for liquidated damages in the event of a breach.

(c) The holder should have made persons in possession under a claim of title parties to any judicial foreclosure proceedings and caused them to be properly served. The final decree should appropriately dispose of the rights of such parties. In nonjudicial foreclosure the holder should have taken any feasible legal steps available under local law, by notice or otherwise, to cut off the rights of any such persons.

d. **Timeliness**

(1) Holders should submit title packages to VA as early as possible because delays are costly to both VA and holders. Holders are not compensated for interest accruals after completion of liquidation.

(2) The time allowed will generally be 60 days from the date of sale or confirmation of sale, whichever is applicable. Each VARO has issued informational releases regarding timeliness and includes this information in the title submission instructions sent with the bid letter. VARO instructions which allow more than 60 days take precedence over the general 60 day rule.

(3) A holder that encounters an unavoidable delay in gathering the necessary title evidence should request an extension before the end of the time limit set by the VARO. The holder should send VA a written explanation of the cause of the delay.

(4) Failure to timely submit a complete title package or an acceptable request for an extension may result in reconveyance of the property.

e. **Title Objections**

(1) When title is found to be unacceptable, the holder may be given a reasonable period of time to correct the objections depending on the circumstances of the particular case. An extension is a matter of discretion and not a legal right. A written stipulation, stating the duration and the conditions of the extension, must be signed by the holder and by VA.

(2) When more than 30 days will be required to cure the title problem, the holder will generally be required to retain or resume custody of the property and to assume responsibility for all carrying charges, such as taxes and maintenance, and any decrease in the value of the property, from the date stated in the stipulation granting the extension until the title is acceptable to VA.

(3) If title objections cannot be cleared within a reasonable time, the holder will be required to retain the property and credit the indebtedness with the specified amount. VA may, at its

discretion, agree with the holder to accept title with an adjustment of the amount that would otherwise be payable, based upon the diminution in the value of the property because of the title defects.

f. **Subsequently Discovered Title Defects.** (38 CFR 36.4320(h)(6)) VA's legal rights are limited in certain respects as to title defects discovered after delivery of a conveyance has been accepted. Generally, once VA has accepted title, the holder is not responsible for clearing defects which are subsequently discovered unless they are covered under covenants or warranties given VA by the holder in conveying the property.

## 5.06 Property Preservation

a. During the time between the foreclosure sale date or confirmation of sale date, and the date of receipt by VA of the holder's notice of election to convey the property, holders should perform emergency property preservation repairs not in excess of $500. Repairs in excess of $500 must be approved in advance by VA. This limitation does not apply to expenditures for heat, water, electricity, or other services where:

(1) Properties are occupied by tenants,

(2) The terms of the rental agreements require the landlord to furnish such services; and

(3) Upon acquisition of the property by the holder the tenants are obligated to pay rents to the holder.

b. VA will generally assume these functions when custody of the property is transferred.

## 5.07 Rentals

a. The holder may not rent the property to a new tenant or extend an existing tenancy on other than a month-to-month basis unless the prior approval of VA is obtained. (38 CFR 36.4320(h)(3))

b. When the holder has continued custody of the property, or custody has been returned to the holder by VA, the holder must, after conveyance to VA, account for all rents and other income collected and authorized disbursements made. (38 CFR 36.4320(h)(9)) If VA declines to accept a conveyance of the property over which it assumed custody, it will account to the holder for collections and disbursements.

## 5.08 Hazard Insurance (38 CFR 36.4320(h)(2))

a. The holder must not cancel any insurance in force when it acquires the property unless the VA office of jurisdiction has specifically waived this requirement and requested that the policy be canceled and a refund of the unearned premium obtained. VA may take such action

in areas in which the insurance policy in force does not extend coverage to a party who acquires title through foreclosure or to that party's grantee.

b. After a property has been conveyed to VA, the holder must deliver to VA, properly endorsed, all hazard insurance policies in force which had been obtained before the holder acquired the property. Policies are to be endorsed so that any amounts payable by the insurer will be paid to VA. The endorsement should be made out to "Secretary of Veterans Affairs, an Officer of the United States of America, at (VA office of jurisdiction address)."

## 5.09 Taxes (38 CFR 36.4320(h)(4))

The holder must pay any taxes, special assessments, or ground rents due and payable within 30 days after the date of conveyance if the bills are obtainable.

## 5.10 Acceptable Conveyance Expenses (38 CFR 36.4320(f))

The following expenses may be included in any accounting with VA in the computation of a claim under the guaranty, if paid by the holder:

a. Required State and documentary stamp taxes.

b. The customary cost of obtaining evidence of title, as discussed in paragraph 5.05c(3). The costs of title evidence obtained incident to making the loan or any expenses incurred to clear title defects may not be included.

c. Taxes, special assessments, or ground rents, as discussed in paragraph 5.09.

d. Recording fees.

e. Any other expenditures connected with the property approved in advance by VA.

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## CHAPTER 6. CLAIMS PROCEDURES

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# CHAPTER 6. CLAIMS PROCEDURES

## 6.01 General

a. Holders may submit claims under the guaranty after a loan has been terminated by foreclosure or the acceptance of a voluntary conveyance (deed in lieu of foreclosure). A claim must also be submitted if VA elects to purchase, or refund, the loan. In that case, the instructions in paragraph 3.06, Refunding, should be followed. Procedures are also different in a compromise agreement (see par. 3.04).

b. A claim should generally be submitted after all expenses involved with a terminated loan have been paid. VA will accept a supplemental claim at a later date should an item be omitted from the original claim, but as a practical matter, holders should try to include all expenses in the original claim because processing primary claims is given priority over supplementals.

c. For timely payment, it is in the holder's best interest to ensure that the claim form and supporting documents are complete and meet VA requirements.

## 6.02 VA Form 26-1874, Claim Under Loan Guaranty

This form should be submitted in duplicate along with appropriate supporting documents. The original must be signed by a corporate officer or other full-time employee of the holder authorized to execute claims. A completed example of this form appears in figure 6-1. In completing this form, holders should pay special attention to the following items:

a. Claimant (item 1) and holder's loan number (item 3B) when FNMA is the holder. Be sure to list FNMA as the claimant and give the FNMA number as the holder's loan number.

b. **Payments**. This involves principal and interest only, not tax and insurance amounts. Item 5B should total items 5C and 5D. Interest in item 5C must include any interest adjustment shown on the HUD-1 form or VA Form 26-1820, Report and Certification of Loan Disbursement.

c. **Principal Balance (Item 11A)**. This is the unpaid principal balance of the loan after credit is given for all payments received from the borrower.

d. **Balance in T&I Account (Item 11C)**. If any advance was made for the payment of taxes or an insurance premium, the balance should be zero.

e. **Miscellaneous Credits (Item 11G)**. Provide a breakdown and explanation of the amounts involved. Attach a separate sheet if necessary.

f. **Itemized Advances (Item 12)**. If the T&I account balance was not sufficient to pay taxes or insurance when due, only the deficiency (shortage) should be shown as an advance. Late charges or tax penalties must not be included. Care should be taken to itemize advances prior to and after

a cutoff date. Because many advances are subject to caps established by the VA office of jurisdiction, such as property preservation charges and some liquidation costs, holders should obtain current releases on allowable fees from each VA office with which they may be filing a claim and limit the amount claimed for advances to the amount allowable.

## 6.03 Other Required Documents

The following documents are required when submitting a claim:

a. Originals or certified copies of all instruments evidencing the indebtedness and the agreement between the claimant and the debtor. Copies of instruments which have been recorded must show book, page, date, and place of recording. The note or evidence of the debt should be endorsed as follows (except where the holder will not be made whole and plans to pursue collection from the obligor) :

Pay to the order of the Secretary of Veterans Affairs, without recourse.

_____
(Holder)

_____
(Official Signature)

_____
(Title)

The note or other instrument should not be marked "paid" or "canceled."

b. If claimant is an assignee or transferee of the original lender, a certified copy of the instrument of transfer.

c. If a judgment has been obtained, an assignment thereof (in addition to the note, unless by law or order of the court it is retained among the court papers) to the Secretary of Veterans Affairs with advice of the amount, if any, collected on the judgment.

d. Certification that the loan termination has been reported to the credit bureaus.

e. A certified statement of account. This in effect should be a copy of the ledger sheets or equivalent showing the amounts and dates of all debits and credits to the account.

f. Copies of all deeds transferring title from the original veteran-obligor through the owner holding title at liquidation. Social Security or taxpayer identification numbers of transferees should be annotated on the deeds.

g. Copies of all judicial proceedings involving the foreclosure and any bankruptcies, if not previously provided to VA.

## 6.04 Computation of Claim

a. Ordinarily, a proper claim will be processed within 30 days of receipt if it is in good order and accompanied by the required documents. VA will determine whether the claim is eligible for payment under the guaranty. All claims will be checked for accuracy, the propriety of the charges, and to verify proper disposition of funds.

b. The total amount claimed (item 11H on VA Form 26-1874) does not include interest. VA will calculate the accrued interest from the date of the last paid installment to one of the following dates, whichever is applicable:

(1) The date of liquidation;

(2) The date the deed is recorded (in a voluntary conveyance); or,

(3) A cutoff date established under the provisions of 38 CFR 36.4319(f) or 38 CFR 36.4321(b).

c. For purposes of determining VA's guaranty liability, the total indebtedness as calculated by VA will include unpaid principal, accrued interest to the cutoff date, advances, and liquidation and property preservation expenses if paid prior to the cutoff date and allowable by regulation. Advances and liquidation expenses paid after the cutoff date may be included in the holder's claim and are reimbursable to the extent that the total claim payable does not exceed VA's guaranty liability. Advances for insurance paid after the cutoff date, however, may not be included in the claim. Advances for real estate taxes, assessments, or ground rents paid after the cutoff date are generally fully reimbursable unless a cutoff date which is prior to the liquidation sale date has been established under 38 CFR 36.4319(f), 36.4321(b)(1) or 36.4321(b)(3). If an earlier cutoff date is in effect, these costs may be allowed only on a pro rata basis through the cutoff date. However, advances for taxes which must be paid pursuant to paragraph 5.09 (38 CFR 36.4320(h)(4)) are reimbursable on the same basis as liquidation expenses paid after the cutoff date.

d. VA will also reimburse holders for the cost of the liquidation appraisal, and advances and expenses which were requested to be paid by the holder on behalf of VA. For example, as a result of the timing of a foreclosure sale, property taxes are due more than 30 days after the liquidation sale but there is insufficient time for VA to accept custody of the property and pay the taxes so that a penalty will be avoided. In such a situation, VA might authorize the holder to pay the tax and then reimburse the holder even if payment exceeds the maximum claim payable. Similarly, if a holder obtained VA's prior approval to make emergency repairs to the property, then expenses are reimbursed to the holder.

e. Items or amounts claimed that are not eligible, in excess of the allowable amount, not supported by paid receipt, or not itemized, will be disallowed.

## 6.05 Limit to Claim

The amount paid cannot exceed the amount or percentage guaranteed. The guaranty increases or decreases pro rata with any increase or decrease in the amount of guaranteed indebtedness up to the amount originally guaranteed. For example, if VA originally issued a $36,000, 40 percent guaranty on a $90,000 loan and the indebtedness at liquidation was $95,000, then the guaranty is capped at $36,000. If indebtedness at liquidation on the same $90,000 loan was $80,000, the amount of guaranty would be 40 percent or $32,000.

## 6.06 Partial or Total Loss of Guaranty (38 CFR 36.4325) and Suspension (38 CFR 36.4332)

a. **Forgery.** Forgery of the security instruments, loan or guaranty application or other loan processing documents which are essential to the underwriting process releases VA from guaranty liability on the loan, regardless of the current holder. A counterfeit or falsified discharge certificate or certificate of eligibility is similarly treated.

b. **Fraud or Willful Misrepresentation**

(1) A finding that the original lender obtained guaranty of a loan as a result of willful and material fraud or misrepresentation will provide a basis for denial of liability by VA if the fraud or misrepresentation affected VA's decision to guaranty the loan. Examples of fraud and willful misrepresentation include:

(a) Hiding unacceptable credit by obtaining multiple credit reports and including only the report that shows acceptable credit history in the loan package;

(b) Materially false information in the loan package as a result of allowing the veteran to hand-carry employment, deposit or other income or credit verifications instead of mailing them directly to the employer, depository or other proper source of information;

(c) Not reporting a second lien executed in connection with the loan closing to reimburse the seller or a third party for costs of the transaction which are not payable by the veteran or not disclosed in the loan package; and,

(d) Egregiously poor underwriting; e.g., approval of a loan without resolving obvious discrepancies in the loan package or despite the veteran's clear failure to meet VA's regulatory credit standards.

(2) Denial of liability for fraud or willful misrepresentation applies only to the original lender, and not to a "holder in due course." A holder in due course is one who acquired the loan for value and did not participate in or have notice of the fraud or misrepresentation. A holder that acquired a loan from the original lender in a delinquent status is not considered a holder in due course by VA.

c. **Non-Willful Misrepresentation.** There is no basis for denial of liability by VA when apparent misrepresentation occurs without the willful complicity of the lender, or when the loan was acquired by a holder in due course. These include cases of relatively minor errors in judgment in processing the loan application resulting from misunderstandings of the lender, and cases in which the veteran or some other party intentionally misinforms the lender as to facts used in underwriting the loan and in which prudent underwriters would not find a basis for questioning the information. If the misrepresentation or error is material to approval of the loan and it is determined that knowledge of it was available to the lender prior to closing, VA may reduce its claim liability to the extent that it can be shown to have been increased by the misrepresentation or error.

d. **Violation of VA Requirements**

(1) To the extent that a holder fails to comply with VA servicing requirements, regulations and/or laws applicable to the servicing and origination of GI loans, a claim under Loan Guaranty is subject to adjustment by VA. VA' s general policy in determining the amount of the adjustment is to estimate the dollar amount by which the holder's failure to comply increased the claim payable on the loan. The claim is then adjusted by a corresponding amount. For example: if a holder inadvertently released an obligor from liability, and the obligor willfully defaulted as a result or VA lost a right to pursue collection against the obligor after loan termination, VA would adjust the claim payable to zero (38 CFR 36.4324(f) and 36.4325(b)(1)). Another example: If the holder's failure to obtain a valid lien at loan origination delayed foreclosure of the loan by 10 months, the holder's claim would be reduced by accrued interest and incurred advances and expenses during the 10 month period.

(2) The most common claim adjustments are for failure to report loan defaults timely (38 CFR 36.4315(a)) and failure to begin and prosecute liquidation (38 CFR 36.4319(f)) timely. Adjustments for failure to obtain adequate insurance settlements of hazard losses and to ensure that the settlements are applied to the loan balance or to restoration of the security are not unusual. Most claim adjustments are completely avoidable if holders are familiar with VA's requirements for servicing and liquidating VA-guaranteed loans and maintain internal control systems that monitor compliance. These standards are not significantly different than those expected by FNMA (Federal National Mortgage Association), FHLMC (Federal Home Loan Mortgage Corporation), GNMA (Government National Mortgage Association) and private mortgage insurors. Holders that make an effort to achieve familiarity with VA's requirements and maintain high standards of compliance will benefit, as will veterans and VA.

e. **Debarment**

(1) VA is authorized under section 3704(d) of title 38, United States Code, to debar a holder when a determination has been made that the holder has failed to:

(a) Maintain adequate loan accounting records; or,

(b) Demonstrate proper ability to service loans adequately.

(2) Under 38 CFR part 44, these debarments can be made effective Government-wide. Under 38 CFR 44.305, debarment may also be imposed based on conviction or civil judgment for fraud or criminal offenses, and for willful violation of a statutory or regulatory provision. This includes a willful failure to comply with VA's servicing procedures (38 CFR 36.4346).

(3) Any debarment action will be preceded by a written notice of intention to debar which will detail the servicing deficiencies or other misconduct found by VA. The holder will be given the opportunity to respond in writing and at a personal hearing before action is taken.

## 6.07 Payment and Final Accounting

a. **Advice to Holder.** When the claim is vouchered for payment, a notice will be sent to the holder/servicing agent together with a copy of VA's Analysis of Account and Claim (figs. 6-2 and 6-3).

b. **Return of Evidence of Guaranty.** Immediately following the receipt of a claim payment, the Loan Guaranty Certificate must be returned to VA marked "Canceled" over an official signature of the holder.

c. **Record Retention.** VA regulations do not require holders to retain records for any fixed period of time after a claim is paid. It is recommended that they be retained for 3 years.

## 6.08 Supplemental Claim

A supplemental claim may be filed for any items omitted from the original claim or paid for after it was submitted, or to contest a disallowance on the original claim. It is not necessary to use VA Form 26-1874, but a supplemental claim must be supported by the same documents required for the initial claim, such as receipts. A supplemental claim will be processed in the same manner as an initial claim.